86-261

No.————

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1986

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GARFIELD TRUST COMPANY,

Appellant,

v.

DIRECTOR, DIVISION OF TAXATION,

Appellee.

———o———

On Appeal From The Supreme Court of New Jersey

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JURISDICTIONAL STATEMENT

———o———

GLENN T. LEONARD
CECCHI AND POLITAN
34 Park Avenue
P.O. Box 158
Lyndhurst, New Jersey 07071
(201) 939-1550

Counsel for Appellant

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
or call collect (402) 342-2831

QUESTIONS PRESENTED

1. Whether the Supreme Court of New Jersey may abdicate its responsibility of judicial review and otherwise defy this Court by ignoring the requirements of the Federal Public Debt Statute and the Borrowing and Supremacy Clauses of the United States Constitution as defined by this Court in *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855, 103 S.Ct. 3369, 77 L.Ed.2d 1072 (1983).

2. Whether the Federal Public Debt Statute permits states to create so-called "franchise" taxes that are measured by the net income of a corporation including the income from federal obligations.

3. Whether the Federal Public Debt Statute permits a state to tax the income from federal obligations pursuant to a statute which, when it was combined with a pre-existing franchise tax statute, was intended by the state legislature to create a corporate income tax.

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No.————

In The

Supreme Court of the United States

October Term, 1986

GARFIELD TRUST COMPANY,

Appellant,

v.

DIRECTOR, DIVISION OF TAXATION,

Appellee.

On Appeal From The Supreme Court of New Jersey

JURISDICTIONAL STATEMENT

Appellant, Garfield Trust Company ("Garfield Trust"), now known as County Trust Company, appeals in part from a final judgment of the Supreme Court of New Jersey, entered May 22, 1986, upholding the validity of a New Jersey statute, N.J.S.A. 54:10A-1 to -40, which Garfield Trust had challenged on the ground that, as applied

to it, the statute violates the laws of the United States and is repugnant to the Constitution.

OPINIONS BELOW

The decision of the Supreme Court of New Jersey from which this appeal is taken is reported as *Garfield Trust Company v. Director, Division of Taxation,* 102 N.J. 420 (1986), Appendix, pp. 1a-18a. That decision affirmed the judgment of the Superior Court of New Jersey, Appellate Division in *Garfield Trust Company v. Director, Division of Taxation,* 7 N.J. Tax 664 (1985), Appendix 19a-20a. The trial court decision affirmed by the Superior Court of New Jersey, Appellate Division is reported as *Garfield Trust Company v. Director, Division of Taxation,* 6 N.J. Tax 462 (1984), Appendix, pp. 21a-34a.

JURISDICTION

The final judgment of the Supreme Court of New Jersey was entered May 22, 1986. (Appendix, p. 1a). That judgment upheld the validity of a New Jersey statute, N.J.S.A. 54:10A-1 to -40 challenged by Garfield Trust as being violative of the laws of the United States and repugnant to the United States Constitution. Notice of appeal from that judgment was filed in the Supreme Court of New Jersey on August 13, 1986. Appendix, pp. 35a-37a.

The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(2) because there has been drawn in question the validity of a state statute on the grounds of it being repugnant to the laws of the United States and the United States Constitution, the decision below having been in favor of its validity. The judgment of the Supreme Court of New Jersey is final for the purpose of review by this

Court under 28 U.S.C. § 1257(2). *See, Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469, 479-480 (1975).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

CONSTITUTIONAL PROVISIONS

Supremacy Clause, U.S. Const., Art. VI, cl. 2:

> This Constitution and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Borrowing Clause, U.S. Const. Art. I, § 8, cl. 2:

> Section 8. The Congress shall have Power . . .
>
> To borrow money on the credit of the United States . . . .

FEDERAL STATUTE

Federal Public Debt Statute, Rev. Stat. § 3701, 31 U.S.C. § 742[1] *as in effect in 1976, the year involved in this case:*

> Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States shall be exempt from taxation by or under State

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[1] The present Federal Public Debt Statute, 31 U.S.C. § 3124, as amended by Pub. L. No. 97-258, Sept. 13, 1982, reads in relevant part:

> "(a) Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except—
>
> "(1) a nondiscriminatory franchise tax or another nonproperty tax instead of a franchise tax, imposed on a corporation; and
>
> "(2) an estate or inheritance tax."

or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

New Jersey Statutes

Corporation Business Tax Act:[2]

N.J.S.A. 54:10A-2
N.J.S.A. 54:10A-4(d)
N.J.S.A. 54:10A-4(k)
N.J.S.A. 54:10A-5

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STATEMENT OF THE CASE

Garfield Trust brought this action in the Tax Court of New Jersey to recover $89,897 in taxes paid to Appellee, the Division of Taxation in the Department of the Treasury of the State of New Jersey, after the Appellee had denied Garfield Trust's claim for refund of such taxes.[3] The taxes in question concerned Garfield Trust's Corporation Business Tax return for 1977, measured by a percentage of net worth at December 31, 1976 and a percentage of entire net income for the year ended December 31, 1976. Such return was required by the Corporation Business Tax Act ("CBT"), N.J.S.A. 54:10A-1 to -40.

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[2] The portions of the New Jersey Corporation Business Tax Act cited above are set out in the Appendix, pp. 42a-55a.

[3] The amount of the refund claimed by Garfield Trust is not necessarily related to the issues raised by this appeal. The Tax Court of New Jersey deferred consideration of legal arguments and proofs concerning the calculation of the amount of the refund pending disposition of other legal issues. A principal issue not raised by this appeal is whether Garfield Trust should benefit from the deduction of expenses and liabilities that are related to income and assets which Garfield Trust seeks to exempt from the CBT net income and net asset calculations in the event Garfield Trust is successful in its contentions concerning immunity.

The CBT requires every domestic corporation and every foreign corporation not exempted by the CBT to pay an annual tax. N.J.S.A. 54:10A-2, set out at Appendix, p. 42a.[4] The CBT is computed by adding together prescribed percentages of a net worth base and an entire net income base. N.J.S.A. 54:10A-4(d), 4(k) and 5, set out at Appendix, pp. 43a-49a.[5] The net worth base is broadly defined under N.J.S.A. 54:10A-4(d), Appendix, p. 43a, constituting in essence the stockholders' book equity in the corporation subject to some adjustments, but does not specifically refer to federal obligations. The entire net income base is defined by N.J.S.A. 54:10A-4(k) to mean total net income from all sources, and is deemed *prima facie* to be the amount of taxable income reported for federal income tax purposes, before certain federal deductions and certain other adjustments to the federal taxable income base, but the statute does not specifically refer to income from federal obligations. See Appendix, p. 7a, note 4.

When Garfield Trust Computed its tax liability under these provisions it included its holdings of federal obligations in its net worth base and it included income from these same securities in its net income tax base. Most of its federal obligations were U.S. Treasury bonds and notes. Such inclusions were consistent with the Appellee's administra-

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[4] Garfield Trust first became subject to the CBT for the year 1976 by virtue of a 1975 amendment to the CBT pursuant to which the Bank Stock Tax theretofore imposed on banks in New Jersey (former N.J.S.A. 54:9-1 et seq.) was repealed and banks, both state and national, were placed under the CBT, which is applicable to corporations generally and is not a bank tax. N.J. S.A. 54:10A-34; L. 1975, C.170, § 4.

[5] The CBT in the year involved in this case, consisted of the sum of two separate bases: the net asset base, which was the only portion of the CBT from its original enactment in 1945 until 1958, and the entire net income base, first added in 1958. The net income tax rate was increased various times over the years after 1958, reaching 7½% in 1976, and is now 9%.

tive interpretations of the CBT. Garfield Trust then filed a refund claim with Appellee, who thereafter denied the refund claim.

Garfield Trust contended in the proceedings before the Tax Court of New Jersey that New Jersey's taxation of Garfield Trust's federal obligations was proscribed by the Federal Public Debt Statute, 31 U.S.C. § 742, Rev. Stat. § 3701 ("§ 3701"), and was therefore barred by the Supremacy Clause of the Constitution. U.S. CONST., Art. VI, cl. 2. Appendix, p. 22a. The Tax Court of New Jersey held that the Appellee's denial of Garfield Trust's refund claim was correct because the CBT may properly require inclusion of federal obligations and income in its calculation and held that the CBT was a nondiscriminatory franchise tax within the meaning of § 3701. Appendix, p. 27a.

Garfield Trust appealed to the Superior Court of New Jersey, Appellate Division, which affirmed the judgment of the New Jersey Tax Court in a *per curiam* opinion substantially for the reasons expressed in the Tax Court's opinion. Appendix, pp. 19a-20a.

Garfield Trust then filed a petition for certification with the Supreme Court of New Jersey, which granted such petition. The Supreme Court affirmed the judgment of the Appellate Division and held that the CBT is a *bona fide* franchise tax for purposes of § 3701 and could therefore include income from federal obligations, and the value of such obligations, in the net income and net asset computation bases of the CBT, against Garfield Trust's challenge that the inclusion of the income and principal of such obligations violated § 3701 and the Supremacy and Borrowing Clauses of the Constitution. Appendix, p. 7a.

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THE QUESTIONS ARE SUBSTANTIAL

A. Introduction

The New Jersey Supreme Court erroneously held that the New Jersey CBT constitutes a *bona fide* franchise tax for purposes of the Federal Public Debt Statute, § 3701, and that the CBT may therefore include such federal income and obligations in the calculation of the tax. This Court should reverse such holding for the reasons discussed below.

B. Background of Immunity of Federal Obligations From State Taxation

The Constitution of the United States is supreme and the laws of the United States, when made in pursuance of the Constitution, form the supreme law of the land. U.S. CONST., Art. VI, cl. 2, p. 3 above; *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 4 L.Ed. 579 (1819).

The power of the United States government to Borrow is so fundamental to its supremacy, indeed to its ability to survive, that such power is expressly enumerated in the Constitution. U.S. CONST., Art. I, § 8, cl. 2, p. 3 above. This Court has therefore held that State and local governments may not constitutionally tax federal obligations. *Weston v. Charleston*, 27 U.S. (2 Pet.) 449 (1829); *Society for Savings in the City of Cleveland v. Bowers*, 349 U.S. 143, 144 (1955).

In pursuance of these fundamental constitutional principles, over the years Congress has enacted various federal statutes known generally as the Federal Public Debt Statute ("§ 3701"). The New Jersey CBT constitutes an attempt by that State to circumvent these constitutional principles and federal statutes which were created to protect the federal borrowing power from state encroachment.

Prior to 1959, for many years this Court made a formalistic distinction for immunity purposes between (a)

state taxes on property (including federal obligations), which were prohibited under immunity principles[6], and (b) state taxes on the exercise of a distinct property interest, such as a pure franchise or a distinct transaction such as an inheritance, which were not prohibited so long as they did not discriminate against federal obligations.[7] This legal distinction persisted despite this Court's recognition that the practical impact of both types of taxes was indistinguishable and thus economically meaningless. *American Bank*, 463 U.S. 855, 858, 862, 103 S.Ct. 3372, 3374 (1983) *citing Society for Savings*, 349 U.S. at 147-148, 75 S.Ct. at 609-610.

In 1959, Congress amended § 3701 by adding a second sentence, set out at pp. 3-4 above.[8] In *American Bank*, 463 U.S. at 862, 103 S.Ct. at 3374, this Court elaborated on the "sweeping" exemption provided by the 1959 amendment:

> The 1959 amendment rejected and set aside this Court's rather formalistic pre-1959 approach to § 3701 . . . . Under the plain language of the 1959 amendment . . . the tax is barred regardless of its *form* if federal obligations must be considered, either directly or indirectly, in *computing* the tax.

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[6] *See, e.g., Society for Savings in City of Cleveland v. Bowers*, 349 U.S. 143, 75 S.Ct. 607, 99 L.Ed. 950 (1955); *New Jersey Realty Title Ins. Co. v. Division of Tax Appeals*, 338 U.S. 665, 675, 70 S.Ct. 413, 418, 94 L.Ed. 439 (1950).

[7] *See e.g., Werner Machine Co. v. Director of Division of Taxation*, 350 U.S. 492, 76 S.Ct. 534, 100 L.Ed. 634 (1956), *aff'g Werner Machine Co. v. Director of Division of Taxation*, 17 N.J. 121 (1954); *Plummer v. Coler*, 178 U.S. 115, 129, 20 S.Ct. 829, 834 (1900).

[8] Title 31 of the United States Code was not enacted into positive law until 1982, when it was reformulated without substantive change. Rev. Stat. § 3701, 31 U.S.C. § 742, then was replaced by 31 U.S.C. § 3124(a), set out at p. 3 above, n.1. Act of Sept. 13, 1982, 96 Stat. 877, 945. Because the state tax at issue here was levied for a tax year prior to 1982, the former § 3701, 31 U.S.C. § 742, as amended in 1959, rather than the present 31 U.S.C. § 3124(a), technically controls this case.

Since the Court below held that the CBT properly requires inclusion of income from federal obligations and the value of such obligations in the calculation of the CBT, its judgment must be reversed unless the CBT is a "franchise" tax for purposes of § 3701.

The question whether the CBT is a franchise tax as that term is used in § 3701 is a federal question, to be determined in the final analysis by this Court. *Werner Machine,* 350 U.S. at 493, 76 S.Ct. at 535; *New Jersey Realty Title Ins. Co.,* 338 U.S. at 674, 70 S.Ct. at 418. The United States Supreme Court is not bound by the characterization given the CBT by New Jersey courts nor by the New Jersey legislature, but has an independent duty to consider the real nature of the CBT and its effect upon the immunity of federal obligations from state taxation. *Society for Savings,* 349 U.S. at 151, 75 S.Ct. at 612.

C. The New Jersey Supreme Court Abdicated its Responsibility of Judicial Review and Defied this Court by Rejecting the Principles of Review Established in Werner Machine and American Bank, and by Ignoring the Public Policies and Federal Interests Embodied in the Federal Public Debt Statute.

The New Jersey Supreme Court's opinion is devoid of the kind of thorough, substantive review in which it and this Court engaged in their opinions in *Werner Machine* in order to determine whether the tax considered there was a *bona fide* franchise tax for purposes of § 3701. In order to make that determination, that 1954 opinion of the Court below (17 N.J. at 126-127) not only analyzed the CBT as it then existed in terms of its subject of taxation ("the privilege of exercise . . . of corporate powers in this State") and the measure of the tax ("the net worth or present value of the investment in the corporation"), but also examined the underlying theory of such taxation, stating, at 127:

> It may be said that a franchise tax imposed on a corporation for the privilege of doing business under a corporate charter is based upon the potential of the corporation for doing business under the direction and protection of the laws of the State. *Cf. Corporations—Theory of Organizational Franchise Taxation—Michigan Franchise Tax,* 48 *Mich. L. Rev.* 1130, 1132-1133 (1950). (*"Theory of Franchise Taxation"*)

In affirming the decision of the New Jersey Supreme Court in *Werner Machine,* this Court found that the court below had, on independent examination, found the tax to be "a *bona fide* franchise tax" and this Court further found "no basis in this instance for not accepting the state court's [characterization of the CBT]." *Werner Machine,* 350 U.S. at 493, 76 S.Ct. at 535.[9]

Rather than engaging in the kind of review which had been made in *Werner Machine,* the Court below relied primarily upon an extension of the holding in *Werner Machine* to support its decision in this case. The New Jersey Supreme Court states that the "holding and implications of *Werner Machine* retain their vitality through recent decisions", simply citing *American Bank* and *Memphis Bank & Trust Co. v. Garner,* 459 U.S. 392, 103 S.Ct. 692, 74 L.Ed.2d (1983). Appendix, pp. 10a-11a. It is erroneous to state that either the holding or implications of *Werner Machine* retain their vitality through *American Bank* or *Memphis Bank.* The tax considered in *American Bank* was a bank shares tax; there was no contention that it was a franchise tax. In *Memphis Bank,* since this Court decided that the state bank tax considered there was discriminatory, the Court expressly left open the question whether the tax,

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[9] In affirming, however, this Court did not overrule, but merely distinguished, an earlier case involving a tax whose economic effect was virtually the same as the tax in *Werner Machine—New Jersey Realty Title Ins. Co. v. Division of Tax Appeals,* 338 U.S. 665, 70 S.Ct. 413, 94 L.Ed. 439 (1950).

which was measured by net income, constituted a franchise tax under § 3701. 459 U.S. at 397, 103 S.Ct. at 695, n.6. Therefore it cannot be said that either the holding or implications of *Werner Machine* readily support the holding below.

The CBT involved in this appeal is so different from the CBT involved in *Werner Machine* in so many material respects that this Court's characterization of that 1956 tax for federal immunity purposes has little if any bearing upon this case. In reviewing the CBT in this case, the Court below acknowledged that the net income base was added to the tax after *Werner Machine* was decided, yet failed to inquire whether such a measure was consistent with the underlying theory of franchise taxation delineated in *Werner Machine*.[10]

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[10] None of the cases relied upon by the Court below and otherwise referred to in this Court's opinion in *Werner Machine* constitute holdings that state taxes measured by net income may include income from federal obligations against a federal immunity challenge under § 3701. *Pacific Co. v. Johnson*, 285 U.S. 480, 52 S.Ct. 424, 76 L.Ed. 893 (1932), cited in the opinion of the Court below, Appendix, p. 8a, n.5, involved a question of the applicability of a state tax measured by entire net income of corporations to income from *municipal bonds, not federal obligations*, against a challenge under the Contract Clause of the Constitution, U.S. Const., Art. I, § 10. No federal immunity question under § 3701 was presented. *Tradesmens National Bank of Oklahoma v. Oklahoma Tax Comm'n*, 309 U.S. 560, 60 S.Ct. 688, 84 L.Ed. 947 (1940), also cited in n.5 of the opinion of the Court below, did uphold a state tax on a national banking association, measured by its net income including income from federal obligations, and thus *appears* to constitute a holding by this Court that income from federal obligations may be considered in the computation of a "franchise tax measured by net income." *See New Jersey Realty Title Ins. Co.*, 338 U.S. at 673-674, 70 S.Ct. at 418, n.6. However, the Court's apparent holding that the state tax in that case was a "franchise" tax was unnecessary to the actual holding, since states were authorized by Congress to impose a bank tax "according to or measured by net income" under the "fourth method" of the Federal Statute Regarding State

(Continued on following page)

The Court below states Appendix, p. 10a, note 6, second ¶ that the fact that the threshold activities by corporations triggering CBT liability are the same today as they were in *Werner Machine* "confirms that the CBT remains a franchise tax." However, that Court ignores its analysis of the CBT in *Roadway Express, Inc. v. Director, Division of Taxation*, 50 N.J. 471 (1967), *app. dism.*, 390 U.S. 745, 20 L.Ed.2d 276 (1968), in which the Court found it highly significant that the CBT was not founded merely upon the privilege of exercising a corporate franchise (a major aspect of the CBT which was emphasized in *Werner Machine*), but also upon other privileges as well. *See* Appendix, p. 42a. In *Roadway Express*, the Court found that the CBT—

(Continued from previous page)

Taxation of National Banks, Rev. Stat. § 5219, 12 U.S.C. § 548 ("§ 5219"), which was not even labeled as a "franchise" tax by § 5219; moreover, the question of immunity of federal obligations under § 3701 was not involved in the case or necessary to the Court's actual holding. Therefore the discussion in *Tradesmens National Bank* concerning franchise taxes is *dictum* and that case is not valid authority for an analysis of valid measures of a state tax for immunity purposes under § 3701.

Other cases in this vein are also inapplicable because they do not involve § 3701 federal immunity challenges with respect to federal obligations and hence do not involve the Borrowing Clause. *Educational Films Corp. v. Ward*, 282 U.S. 379, 51 S.Ct. 170, 75 L.Ed. 400 (1931), involved the question whether income from federal *copyrights* (not federal obligations) held by a corporate taxpayer could be subjected to a state tax measured by entire net income despite the taxpayer's challenge that copyrights and income therefrom are immune from state taxation since they are instrumentalities of the federal government, taxation of which the Constitution impliedly forbids. *Id.*, 282 U.S. at 386, 51 S.Ct. at 171.

Flint v. Stone Tracy Co., 220 U.S. 107, 147-148, 31 S.Ct. 342, 347, 55 L.Ed. 389 (1911), is completely irrelevant for § 3701 immunity purposes since it involved a *federal* corporation tax statute challenged under the provisions of the Constitution dealing with federal taxation powers.

> was certainly intended to reach foreign corporations doing an intrastate business, an interstate business, or both, as far as could constitutionally be done, and its disjunctive recital of the various privileges must be considered with the intended overall coverage in mind. . . . The privileges taxed . . . are stated . . . in the alternative and are not confined . . . to that "of carrying on or doing business within the State" (citation omitted.).

50 N.J. at 483. This characterization of the basic theoretical underpinning of the CBT is so completely different from that Court's much narrower characterization of the foundation for the CBT in *Werner Machine,* and emphasized by this Court in its opinion in *Werner Machine.*[11] that the relevance of the holding in *Werner Machine* to both the net asset and net income bases of the CBT today is certainly questionable.

In what little analysis was mustered to analyze the CBT, the Court below found that the central purpose of the addition of the net income measure in 1958 was to provide an increase in the state's revenues, citing *Roadway Express.* Appendix, p. 9a. In a surprising *non sequitur,* the Court below then states:

> The essential purpose *hence* was not to change the conceptual nature of the tax, which the Legislature continues to dub an "annual franchise tax," . . . to an income tax.

Id. (Emphasis added). The fact that a new tax statute's purpose is to increase revenue is obvious. However, stating such a purpose is of no value in determining whether another purpose was to enact a corporate income tax or instead a tax "measured by" net income. This loose analysis by the Court below all too conveniently overlooks the sub-

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[11] This Court referred in its opinion in *Werner Machine* only to the "privilege of having or exercising its corporate franchise" in the State. 350 U.S. at 492, 76 S.Ct. at 534.

stantial ambiguities which exist in the legislative history concerning whether the actual intent of the New Jersey legislature was to create a corporate income tax or a *bona fide* franchise tax measured by net income. The reports of the tax commissions dealing with 1958 and 1972 amendments to the CBT repeatedly refer to the net income base as an "income tax" and distinguish it from the net asset base, referring to the latter as the franchise tax. Such reports fail to state any intention to create a *bona fide* franchise tax measured by net income.[12]

The Court below further overlooks its own contributions to and recognition of such ambiguities in its past decisions characterizing the addition of the net income measure of the CBT. The New Jersey Supreme Court previously found such addition significant in extending the CBT to a foreign corporation which was not subject to the state's franchising authority. *Roadway Express*, 50 N.J. at 477. In that case the court found the CBT to have "all the attributes of a direct levy on income" except for its addition to the pre-existing CBT due to historical antipathy in New Jersey to an income tax labeled as such. *Id.* at 485, Even more recently, the New Jersey Supreme Court in *Silent Hoist & Crane Co. v. Director, Division of Taxation*, 100 N.J. 1, 12 (1985) found that the net income measure of the CBT is "[in] essence . . . a corporate income tax, although at the time [of its addition] denominated a franchise tax due to a surmised 'historical antipathy in New Jersey to an income tax as such.'" (*quoting Roadway Express*, 50 N.J. at 485).

Because the Court's responsibility below was to determine by independent examination whether the state tax in question constitutes a *bona fide* franchise tax for purposes

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[12] See Part E. below.

of § 3701, the Court erred in applying a precedent whose holding (as to a tax fundamentally different from the present CBT) is irrelevant to this case, and since the legislative history of the 1958 amendment to the CBT and the subsequent decisions of the New Jersey Supreme Court characterizing that amendment give rise to substantial ambiguities concerning whether such amendment in fact constituted, or was intended to constitute, a *bona fide* franchise tax. The Court further erred as it did not observe the principle that any ambiguities with respect to the characterization of the tax must be resolved in favor of declaring immunity of federal obligations from state taxation. *Werner Machine,* 350 U.S. at 493, 76 S.Ct. at 535, *citing Society for Savings,* 349 U.S. at 154, 75 S.Ct. at 613, which had so held.

More important, however, than the foregoing errors is the New Jersey Supreme Court's refusal to follow the principles of review recently established in regard to § 3701 by this Court in *American Bank.* In *American Bank,* this Court decried the pre-1959 technical formalism which had produced different holdings as to the taxation of federal obligations in cases respectively involving state taxes which were virtually identical in terms of economic incidence, 463 U.S. at 858, 103 S.Ct. at 3372, and stated that under the 1959 amendment to § 3701, the emphasis must be upon the economic incidence of the given tax rather than its mere form or label. *Id.* at 862, 103 S.Ct. at 3374. This Court also examined the nature of the federal interest in protecting its borrowing power from intolerable state tax burdens. In extending the holding of *Werner Machine* to the net income measure of the CBT in this case, the New Jersey Supreme Court has not only perpetuated the old formalism existing before 1959, contrary to this Court's requirements in *American Bank,* but has also totally failed to consider the nature of the federal interests embodied in § 3701 and

whether an extension of the *Werner Machine* holding to a tax measured by net income would adversely affect those federal interests.

The discussion in *American Bank* of the legislative history of the 1959 amendment reveals that a special federal concern about taxes measured by net income in particular was the catalyst for the amendment; the amendment's broadening of the statutory exemption was intended to prevent states from taking advantage of what would otherwise be a legal loophole permitting taxes which placed the same economic incidence on federal obligations as did direct income taxes on the interest from federal obligations, such latter taxes having been held to be an unconstitutional and intolerable burden on the federal government. *American Bank,* 463 U.S. at 865-867.

The Court below misstates the legislative history of the 1959 amendment to § 3701: "[i]n 1959, Congress amended the Federal Public Debt Statute by adding the second sentence to incorporate the *Werner Machine* holding". Appendix, p. 7a. This characterization of Congressional purpose is unsupported by the legislative history of such amendment, which does not refer to *Werner Machine. Public Debt Ceiling and Interest Rate Ceiling on Bonds: Hearings Before the House Committee on Ways and Means,* 86th Cong., 1st Sess. 69-72 (1959) (Statement of Secretary of the Treasury Anderson). ("Anderson Statement.") In fact, the only case cited in the Anderson Statement is *New Jersey Realty Title Ins. Co.,* which held invalid a New Jersey tax which had virtually the same economic effect as the tax in *Werner Machine,* and which also held that § 3701 as it then existed (prior to the 1959 amendment) also exempted interest on federal obligations from state taxation even though the statutory language

did not expressly refer to interest. Therefore, if Congress intended to codify the holding of any case by the 1959 amendment to § 3701, the legislative history shows that it was not *Werner Machine* but *New Jersey Realty Title Ins. Co.,* particularly that aspect of the latter case which made clear that state taxes on or measured by income including interest from federal obligations are invalid under § 3701.

The legislative history of the 1959 amendment to § 3701 shows that even though this Court had decided in *New Jersey Realty Title Ins. Co.* that § 3701 exempted the ***interest*** on federal obligations, as well as the obligations themselves, from state taxation, the United States Treasury and Justice Departments as well as the House Ways and Means Committee were concerned that such exemption might not extend to state taxes "measured" by net income as well as direct state income taxes. Anderson Statement, at 69-70. Idaho apparently defended its inclusion of income from federal obligations in a 1933 Idaho tax measured by net income by taking the position that § 3701, even as interpreted by *New Jersey Realty Title Ins. Co.,* prohibited the inclusion of exempt federal interest in direct income taxes only. Idaho's rationale did not rest upon a theory of lack of Congressional power to exempt interest on federal obligations from a state tax measured by net income, but rather upon the theory that Congress had not exercised such power. *Id.* at 71.

The United States Treasury and Justice Departments therefore recommended in response to this position that the matter would be resolved most simply by Congressional action—

> which would *clarify the exemption by expressly exempting Federal obligations and the interest on them from every form of State and local taxes.*

Id. (Emphasis added). The Anderson Statement furthermore makes it clear that the Idaho statute was not the sole concern. Instead, there was a broad concern that other states might take similar legal positions in an attempt to tax interest from federal obligations under taxes measured by net income, which could have a "serious adverse effect on the sale of [federal obligations]" and which also "could have undesirable effects on Treasury financing operations in general." *Id.* at 72.

Further evidence of the Congressional concern about the threat of income taxes is evident from the "Section-By-Section Analysis of A Bill to Facilitate Management of the Public Debt", also contained in the Anderson Statement, at 82 Appendix, p. 41a, where the proposed amendment to § 3701 is described as follows:

> Section 5 would make it clear that present provisions of law exempting obligations of the United States from State and local taxation cover State income taxes.

In the context of the history concerning the Idaho tax, it is clear that the thrust of the concern is indirect as well as direct State income taxes of all kinds. This history confirms that Congress intended to

> abolish the formalistic distinction between taxes *on* income and taxes *measured by* income that underlay Idaho's arguments.

First National Bank of Atlanta v. Bartow County Bd., 470 U.S. —, 105 S.Ct. 1516, 1523 (1955) (Emphasis in original), *citing* Anderson Reports at 69-72.

This legislative history thus shows that Congress considered state taxes measured by net income which included interest from federal obligations to be just as intolerable a burden on the ability of the United States to finance its operations as direct income taxes. Congress was at-

tempting to solve borrowing problems existing at the time, was clearly aware of the adverse impact which state income taxes (whether direct or indirect) on income from Federal obligations would have upon the federal government's ability to borrow, and desired to clarify § 3701 to close a perceived legal loophole.

American Bank further reveals, through its analysis of the language of the 1959 amendment to § 3701, the transformation of that statute from a simple expression of statutory immunity to a very broad, all-encompassing prohibition on any kind of state taxation, however calculated, with narrow exceptions. *Id.* at 864, 103 S.Ct. at 3375. Such drafting leaves no room for a state to contend, as states could previously contend, that a tax is outside of § 3701 because the tax is not imposed on the federal obligations or income therefrom. *Any* tax, direct or indirect, whether imposed on or measured by, is prohibited under the language of § 3701 as amended.[13]

The New Jersey Supreme Court states that its conclusion below is also somehow supported by the failure of

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[13] The new structure of the statutory language introduced in 1959, is one more reason that it was plain error as a matter of basic statutory construction for the New Jersey Supreme Court to extend the *Werner Machine* holding, with respect to a net asset tax, by *implication* to the net income measure of the CBT. Appendix, p. 8a. Such an extension constitutes a refusal to follow this Court's reading in *American Bank* of the effect of the broadened statutory language of § 3701, which this Court held—

> "encompasses 'every form of taxation,' *and is inconsistent with implied exceptions.*"

Id. at 864, 103 S.Ct. at 3375. The conclusion that an exception for taxes measured by net income may not be implied in this case is consistent with the legislative history of the 1959 amendment, which demonstrates that the amendment was adopted at least in part in order to foreclose possible contentions that Congress had not previously acted to prohibit taxes measured by income (as opposed to direct taxes, which were prohibited under § 3701 as interpreted by this Court in *N.J. Realty Title Insurance* Co.).

Congress to make a specific reference to state corporation taxes measured by net income when it amended § 3701 in 1982. Appendix, p. 10a, note 6, 3rd ¶. This weak attempt by the Court to bolster its holding is of no value. The Court's statement that Congress was aware of the increase in the use of net income-measured franchise taxes is unsupported in that the legislative history concerning such amendment and the language of the amendment itself[14] are devoid of any reference to existing state taxes measured by net income, whether in relation to Federal immunity principles or otherwise. Even more importantly, it is clear from the legislative history that the 1982 amendment of § 3701 was a codification law and thus the courts are to presume that any change in language was *not* intended to make any substantive change to existing legislation. H.R. Rep. No. 651, 97th Cong., 2d Sess. 1 (1982). It is therefore improper to attempt to draw any inference whatsoever from the circumstances surrounding the 1982 amendment, particularly where, as here, the inference is intended to support an interpretation of a state tax which attempts to come within an exception to the very important federal immunity requirements.

The addition of the net income measure to the CBT in 1958 (including the legislative history thereof,[15]), the broader bases of the CBT emphasized by the New Jersey Supreme Court itself in *Roadway Express,* and the 1959 amendment to § 3701 (including its legislative history showing Congressional concern about the adequacy of interest rates paid on federal obligations, Congressional recognition of the relationship between the investment attractiveness of federal obligations and after-tax yields,

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14 See note 1, *supra*.

15 See Part E, *infra*.

and Congressional hostility to state income taxes, whether on or measured by income from federal obligations, however such taxes might be labelled) are all factors which require a thorough analysis of today's CBT by this Court. Such factors certainly do not permit the lower Court's blind adherence to, or extension by implication of, the holding in *Werner Machine*. Nor do they support or justify the kind of elevation of form over substance in the decision below which this Court generally decried in *American Bank*. There is no discussion by the New Jersey Supreme Court, and thus apparently no recognition of the need for a meaningful analysis, of the underlying federal interests. Appellant asserts that such analysis is critical to a proper interpretation of the term "franchise" tax for *federal immunity purposes*.

D. The Federal Public Debt Statute Prohibits States from Creating So-called Franchise Taxes that are Measured by the Net Income of Corporations Including the Income from Federal Obligations Because the Nature of a Tax Measured by Net Income Prevents it from Qualifying as a Franchise Tax for Immunity Purposes under § 3701.

To the extent that *Werner Machine* continues to have validity after the 1959 amendment to § 3701, such validity must be limited to the type of state tax considered in that case, *i.e.* not merely a tax which is *labeled* as a franchise tax by the state imposing the tax, but also a tax whose *measure* is both (a) reasonably related to the value of the state-granted franchise which is the subject of state taxation and (b) consistent with the federal interest of preventing state "taxes which diminish in the slightest degree the market value of the investment attractiveness of obligations issued by the United States in an effort to secure necessary credit." *Memphis Bank*, 459 U.S. at 396, 103

S.Ct. at 692, 695 (1983), *citing Smith v. Davis,* 323 U.S. 111, 117, 65 S. Ct. 157, 160, 89 L.Ed. 107 (1944).

Traditional franchise taxes are typically measured by net assets, authorized or issued capital, or similar indices which are reasonably reflective of the value of the state-granted franchise[16] because they reflect the corporation's potential for doing business under the state's protection. *Werner Machine,* 17 N.J. at 127, *Citing Theory of Franchise Taxation, supra.* As such, this type of tax is analogous to other licensing statutes, such as liquor licenses, food permits, and so forth, which impose uniform annual excise/franchise fees for the privilege of having the license, *i.e.* to reflect the value of the government-granted opportunity. Moreover, such traditional forms of franchise taxes do not diminish the market value or investment attractiveness of federal obligations since the corporation will pay the same franchise tax regardless of whether or not the corporation holds federal obligations, and the existence of such a tax will not affect the interest rate to be paid by the United States (or, stated differently, the interest rate sought by the corporate investor).

Taxes measured by a net income base, on the other hand, are not reasonably related to the value of the state-granted franchise, because the measure of such a tax reflects *actual results,* not potential. Even more importantly for purposes of federal immunity analysis, state taxes measured by net income are in direct conflict with the Federal Public Debt Statute and the Supremacy and Borrowing Clauses of the Constitution because such taxes undeniably diminish the market value and the investment attractiveness of federal obligations by decreasing the after-

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[16] Cf. *New Jersey Realty Title Ins. Co.,* 338 U.S. 674, 70 S Ct. at 418, n.6.

tax yield derived by purchasers of such obligations. As discussed above, the 1959 amendment to § 3701 was enacted as part of the larger background of Congressional concern about the ability of the United States to borrow in a period of rising interest rates. Congress was aware not only of the necessity of providing for adequate interest rates, but also of the adverse effect which state taxes measured by income could have upon the interest rates which the United States would have to pay in order to borrow if such taxes were not prohibited from including interest on federal obligations.[17] In light of the federal interests at stake, the special exception or exemption to the general prohibition of § 3701 must rest upon the Appellee. *FTC v. Morton Salt Co.*, 334 U.S. 37, 44-45, 68 S.Ct. 822, 827-828 (1948); *U.S. v. First City National Bank*, 386 U.S. 361, 366, 87 S.Ct. 1088, 1092 (1967).

The power granted to states by § 5219 to tax national banks does not relieve the Appellee of this burden of proof. As noted by this Court in *American Bank*, 463 U.S. at 870, 103 S.Ct. at 3378, great care must be taken to distinguish between the federal interests sought to be protected by § 3701 (prohibiting state taxes from imposing "an intolerable burden on federal obligations by threatening to diminish their value") and § 5219 (prohibiting state taxes from imposing "an intolerable burden on national banks"). These are "questions that are historically and analytically distinct." *Ibid.* As between these two interests, the inter-

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[17] States have always zealously protected their alleged rights to have the United States refrain from the taxation of income from state and local obligations derived by individual as well as corporate taxpayers. Whether or not states are correct in their interpretation of the Constitution in providing state and local obligations with immunity from such taxation is irrelevant here. It is clear, however, that the immunity from state taxation to which federal obligations are entitled is a direct primary constitutional immunity which is *at least* as great as the converse.

est protected by § 3701 is much stronger since it is a federal power which is *expressly* enumerated in the Borrowing clause of the Constitution.[18] The interest protected by § 5219, on the other hand, rests merely upon a constitutionally *implied* power of Congress to establish national banks, *M'Culloch*, 17 U.S. (4 Wheat.) at 408-409, 4 L.Ed. at 602; so that state taxation of national banks does not threaten to burden the United States to the same extent as state taxation of federal obligations. The historical trend has in fact been for Congress to become increasingly liberal in permitting states to tax modern national banks,[19] while at the same time expanding the statutory prohibition on state taxation of federal obligations by the 1959 amendment to § 3701.

It follows from the foregoing historical and analytical discussion not only that *Tradesmens National Bank* is of no value in construing the term "franchise tax" for § 3701 immunity purposes, but also that dicta in various other cases concerning franchise taxes measured by net income prior to the amendment of § 3701 in 1959 are of limited value. The main focus for § 3701 analysis after the 1959 amendment must be upon the question whether the state tax in question constitutes an intolerable burden on federal obligations because it threatens to impair the Borrowing power of the United States by diminishing in the slightest degree the market value or the investment attractiveness of federal obligations. *Memphis Bank*, 459 U.S. at 397, 103 S.Ct. at 695, *citing Smith v. Davis*. The analysis in *Smith* emphasizes the fact that *interest-bearing*

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[18] *Society for Savings v. Bowers, supra*, 349 U.S. at 144, 75 S.Ct. at 608, citing *Weston v. Charleston, supra*.

[19] See *American Bank*, 463 U.S. at 860, 103 S.Ct. at 3374, n. 3, for earlier texts of § 5219. Cf. dissent in *First Agric. Nat. Bank v. State Tax Comm'n.*, 392 U.S. 339, 348, 88 S.Ct. 2173, 2178 (1968).

federal obligations are protected by § 3701, and applies a practical approach to immunity analysis, namely inquiring whether there is a basis for assuming that the state tax in question will deter third parties from acquiring the exempt federal obligations. It is clear that a state tax on corporations measured by net income including income from federal obligations will tend to deter corporations from purchasing the federal obligations because the after-tax yield which the corporate purchaser will derive is diminished by the state tax. Stated differently, such a tax clearly diminishes the market value and investment attractiveness of such obligations to prospective corporate purchasers. The effect of the economic burden thus placed upon federal obligations is undeniably to increase the interest rate which the federal government is required to pay in order to offset this state tax burden. Surely no form of tax could threaten the Borrowing Power more seriously.

E. The New Jersey CBT Violates the Federal Public Debt Statute Because the Legislative Intent Underlying the Tax Was to Create an Income Tax.

In *Macallen Company v. Massachusetts*, 279 U.S. 620, 49 S.Ct. 432 (1929), this Court struck down as violative of the Borrowing Clause of the Constitution and § 3701 a so-called excise or franchise tax measured by net income that included the value and income of federal obligations. The original form of the state tax had not required the inclusion of the federal income, but the state legislature amended the tax to include such income, a special commission of the legislature specifically noting that banking institutions invested a considerable amount of their assets or surplus in federal obligations, and recommending that the income from such obligations be included in the definition of "net income" of the tax. This Court found Massachusetts' argument that

the intent of the amendment was not to directly tax federal obligations to be less than candid. 279 U.S. at 630-34, 49 S.Ct. at 435-37.

Irrespective of whether the *Macallen* holding is correct as applied to its particular facts, as applied to a tax whose actual *character* has been intentionally changed by the state legislature (*e.g.*, from a franchise tax to an income tax or to some other kind of tax that is clearly prohibited by § 3701 from including the income of federal obligations in its calculation), the philosophy expounded by this Court in *Macallen* is still sound law today.

> If, by varying the form,—that is to say, if by using one name for a tax instead of another, or imposing a tax in terms upon one subject when another is in reality aimed at,—the substance and effect of the imposition may be changed, constitutional limitations upon powers of taxation would come to naught.
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> . . . .
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> These constitute special and compelling reasons why courts, in scrutinizing taxing acts like that here involved, should be acute to distinguish between an exaction which in substance and reality is what it pretends to be, and a scheme to lay a tax upon a nontaxable subject by a deceptive use of words.

279 U.S. at 626, 629, 49 S.Ct. at 434, 435. This Court has adhered to the foregoing advice in reviewing state taxes, always being careful to review the pertinent legislative history to determine what kind of tax the given state legislature intended to create. *New Jersey Realty Title Ins. Co.*, 338 U.S. at 674, 70 S.Ct. at 418; *Tradesmens Nat'l Bank*, 309 U.S. at 566, 60 S.Ct. at 692.

In 1958, in order to raise revenue and impose additional taxes on corporations, the New Jersey Legislature amended the tax that was upheld by this Court in *Werner*

Machine.[20] The purpose of that amendment, as can be gleaned from an examination of the legislative history of the amendment as well as from the characterizations given the present CBT by the New Jersey Supreme Court, was not merely to amend a franchise tax, but to *create* a wholly new, multi-faceted tax on corporations, one of the attributes of which was a corporate income tax. Telltale of such an intent are the constant and consistent references to the "business net income tax" in the report of the legislative commission that recommended the amendment of the CBT. *Ninth Report of the Commission on State Tax Policy* (1958), at xxii, xxiii, 106, 109, 115, Appendix, pp. 56a-59a. In 1972, another commission issued a report recommending an increase in the percentage of net income used to calculate the CBT, which recommendation the New Jersey Legislature followed. In its report, that commission consistently referred to the net income portion of the CBT as a "corporate income tax" and "income tax", and, in fact, characterized the CBT as it then existed as a two-part tax consisting of a franchise tax and an income tax. *Report of the New Jersey Tax Policy Commission* (1972) Vol. V, p. 22, Appendix, p. 60a.

The New Jersey Supreme Court has likewise recognized the fact that the present CBT can no longer be characterized as a mere franchise tax (*Roadway Express*, 50 N.J. at 485; *Silent Hoist*, 100 N.J. at 12), although in its decision below that Court tried to explain away its prior characterizations of the tax in those cases.

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[20] The pertinent language that was added, a definition of "net income", does not expressly require the inclusion of the income of federal obligations. N.J.S.A. 54:10A-4(k), Appendix, pp. 44a-49a. Such income has been included in the calculation of the tax pursuant to the administrative interpretations of the CBT by the Appellee. N.J.A.C. 18:7-5.2(a)(2).

> "To have all the attributes of a direct levy on income, however, is not the same as *otherwise* to have all the attributes of a direct levy on income."

Appendix, p. 9a, note 6.

Perhaps the New Jersey Supreme Court truly feels that as long as a tax is labeled a franchise or privilege tax, even though it is "otherwise" intended to be an income tax, then the federal interests embodied in § 3701 and expressed in the Supremacy and Borrowing Clause of the Constitution have been accomodated. Appellant contends that the explicit prohibition of § 3701 against state taxation of federal obligations except in a franchise tax (which must mean, at the very least, a tax that is clearly intended by the state to be a franchise tax) suggests the contrary, and that a tax intended to be an income tax and "otherwise" called a franchise tax is prohibited by § 3701 from including income from federal obligations in the computation of the tax.

CONCLUSION

For these reasons, this Court should note probable jurisdiction of this appeal.

Respectfully submitted,

GLENN T. LEONARD
CECCHI AND POLITAN
34 Park Avenue, P.O. Box 158
Lyndhurst, New Jersey 07071
(201) 939-1550
Counsel for Appellant

APPENDIX

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SUPREME COURT OF NEW JERSEY

A-85 September Term 1985

GARFIELD TRUST COMPANY,

Plaintiff-Appellant,

v.

DIRECTOR, DIVISION OF TAXATION,

Defendant-Respondent.

Argued January 22, 1986—Decided May 22, 1986

SYNOPSIS

Taxpayer bank filed complaint seeking to have director of Division of Taxation refund some or all of franchise tax payment made under Corporation Business Tax Act. The Tax Court, 6 N.J.Tax 462, affirmed collection of tax, and bank appealed. The Superior Court, Appellate Division, 7 N.J.Tax 664, affirmed, and the Supreme Court granted petition for certification. The Supreme Court, Garibaldi, J., held that the corporation business tax which included federal obligations and income therefrom in tax calculation was not only a modified franchise tax, but also a nondiscriminatory one, and thus did not violate the public debt statute.

Affirmed.

On certification to the Superior Court, Appellate Division.

Glenn T. Leonard argued the cause for appellant (*Cecchi and Politan,* attorneys).

Harry Haushalter, Deputy Attorney General, argued the cause for respondent (*W. Cary Edwards, Jr.,* Attorney General of New Jersey, attorney; *James J. Ciancia,* Assistant Attorney General, of counsel).

William S. Robertson, III, argued the cause for *amici curiae* Summit and Elizabeth Trust Co., et al. (*Williams, Caliri, Miller & Otley,* attorneys; *Mr. Robertson* and *Bruce K. Adler,* on the briefs).

The opinion of the Court was delivered by GARIBALDI, J.

This appeal presents the questions whether, first, the Federal Public Debt Statute, 31 *U.S.C.A.* § 742, and second, the state enabling legislation for debt obligations, exempt the principal and interest income of federal and state obligations from inclusion in the net worth and net income bases for calculating the New Jersey Corporation Business Tax (CBT). A third question of discriminatory treatment is presented only if the federal statute is interpreted to require inclusion of the principal and interest income of federal obligations in these tax bases at the same time that the state legislation is interpreted to require exclusion of the principal and interest income of state obligations, or *vice versa.* To answer these questions, we must determine whether the CBT is a *bona fide* franchise tax, whether the enabling legislation exempts state obligations from such a franchise tax, and finally whether the CBT is a *nondiscriminatory* franchise tax.

The petitioner, Garfield Trust Company (GTC), now known as County Trust Company, is a commercial banking corporation organized under the laws of the State of New

Jersey.[1] In its CBT return for the tax year ending December 31, 1976, GTC included the face value of federal as well as state and local obligations in its net worth tax base, and included interest income from these securities in its net income tax base. After paying the tax, GTC filed a refund claim for $89,897 with respondent, Director of the Division of Taxation (Director), who denied the claim.

GTC then filed a complaint with the Tax Court, which affirmed the Director's denial of GTC's refund claim. 6 *N.J. Tax* 462 (1984). The Appellate Division in an unpublished *per curiam* opinion affirmed the Tax Court substantially for the reasons expressed in that court's opinion.

We granted GTC's petition for certification. —— *N.J.* —— (1985). We affirm.

I

The New Jersey Corporation Business Tax Act (the Act), *N.J.S.A.* 54:10A-1 to -40, was enacted in 1945. (*L.* 1945, *c.* 162) on the recommendation of the *Report of the Commission on Taxation on Intangible Property* (1945), which had endorsed the imposition of a "franchise tax" in lieu of the existing *ad valorem* tax on intangible property. The Act now requires, as it then required, a corporation to pay an annual franchise tax "for the privilege of having or exercising its corporate franchise in this State, or for the privilege of doing business, employing or owning capital or property, or maintaining an office, in this State." *N.J.S.A.* 54:10A-2. The tax now is computed by adding together prescribed percentages of a net worth base and an entire net income base. *N.J.S.A.* 54:10A-4(d), 4(k), and 5.

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[1]Numerous other commercial banking corporations have participated in this case as *Amici Curiae*.

The net worth base is broadly defined under *N.J.S.A.* 54:10A-4(d), constituting "in essence the stockholders' book equity in the corporation . . . ," subject to some adjustments not relevant here. *F.W. Woolworth Co. v. Director, Div. of Taxation*, 45 *N.J.* 466, 473 (1965). The statutory definition is all-inclusive, encompassing the principal value of all securities owned by the corporate taxpayer. *Motor Fin. Corp. v. Director, Div. of Taxation*, 129 *N.J. Super.* 19, 23-24 (App. Div.), certif. den., 66 *N.J.* 319 (1974).

The entire net income base is *prima facie* the amount of taxable income reported for federal income tax purposes, less net operating loss deductions and special deductions. *N.J.S.A.* 54:10A-4(k). But the Legislature has provided for the following adjustments to the federal taxable income base:

> (2) Entire net income shall be determined without the exclusion, deduction or credit of:
>
> (A) The amount of any specific exemption or credit allowed in any law of the United States imposing any tax on or measured by the income of corporations;
>
> (B) Any part of any income from dividends or interest on any kind of stock, securities or indebtedness, except as provided in subsection (k)(1) [which excludes specified dividend income from the tax base] of this section. . . . [*N.J.S.A.* 54:10A-4(k)(2).]

Therefore, the entire net income base *includes* interest income of any kind that is derived from securities or indebtedness, notwithstanding any specific federal or state exemption or exclusion.

II

In 1976, the Federal Public Debt Statute provided that:

> Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. *This exemption extends to every form of taxation that would require that* either *the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.*
>
> [31 *U.S.C.A.* § 742 (emphasis added).[2]]

The nondiscriminatory franchise tax exception to this statute's exemption of the principal and interest income of federal obligations from "every form of taxation" stems from *Werner Machine Co. v. Director, Div. of Taxation*, 17 *N.J.* 121 (1954), aff'd, 350 *U.S.* 492, 100 *L.Ed.* 634 (1956). To come within this exception, and therefore to include the principal and interest income of federal obligations in the net worth and net income bases for computing the CBT, that

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[2]The present Federal Public Debt Statute, 31 *U.S.C.A.* § 3124, as amended by Pub. L. 97-258, Sept. 13, 1982, reads in relevant part:

> (a) Stocks and obligations of the United States Government are exempt from taxation by a State are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except—
>
> (1) a *nondiscriminatory franchise tax* or another nonproperty tax instead of a franchise tax, imposed on a corporation; and
>
> (2) an estate or inheritance tax. [(Emphasis added).]

tax must be a *bona fide* franchise tax, and moreover a *non-discriminatory* franchise tax.

When *Werner Machine* was decided, the Corporation Business Tax Act used only a net worth base. In that case, this Court considered the validity of the Director's policy of including in the net worth base the face value of federal bonds otherwise exempted from taxation by federal law. The Federal Public Debt Statute then provided:

> Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. [31 *U.S.C.A.* § 742.]

In *Werner Machine*, we determined that the CBT was in fact as well as in name an "annual franchise tax" (or a "*bona fide* franchise tax"). 17 *N.J.* at 125. Moreover, we found "nothing in the statute indicative of a tax upon the property owned by the corporation, nor upon a franchise as 'property.'" *Id.* at 126. Since the CBT thus was not imposed directly upon the underlying property of a corporation, but rather upon its franchise or privilege to do business in the state, this Court held that 31 *U.S.C.A.* § 742 did not operate to exempt the face value of the federal bonds from inclusion in the net worth base.

The United States Supreme Court affirmed this decision, stating:

> [W]e find no basis in this instance for not accepting the state court's conclusion that this tax is not imposed directly on property held by the corporation. . . . Since the tax remains the same whatever the character of the corporate assets may be, no claim can be sustained that this taxing statute discriminates

against the federal obligations. And since this is a tax on the corporate franchise, it is valid despite the inclusion of federal bonds in the determination of net worth. *This Court has consistently upheld franchise taxes measured by a yardstick which includes tax-exempt income or property, even though a part of the economic impact of the tax may be said to bear indirectly upon such income or property.*

[*Werner Machine*, 350 *U.S.* at 493-94, 100 *L.Ed.* at 637 (emphasis added).]

Hence, the Supreme Court decision in *Werner Machine* clearly established that the CBT, as a *bona fide* franchise tax, was not imposed directly upon the underlying property of a corporate taxpayer, and therefore that 31 *U.S.C.A.* § 742 did not operate to exempt the federal bonds from the net worth measure of the tax. In 1959, Congress amended the Federal Public Debt Statute by adding a second sentence to incorporate the *Werner Machine* holding.[3]

Shortly after *Werner Machine*, in 1958, the net income base was enacted (*L.* 1958, *c.* 63), becoming effective for the 1959 and subsequent tax years. *N.J.S.A.* 54:10A-32.[4] GTC and *Amici* grant that *Werner Machine* held that the self-designated "annual franchise tax" then exacted under

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[3]The amendment is the italicized portion of 31 *U.S.C.A.* § 742 set forth *supra* at pp. 4-5.

[4]The Director, by regulations initially adopted in 1959 and presently incorporated in *N.J.A.C.* 18:7-5.2(a)(2), has provided that entire net income shall include:

> All interest income from sources within the United States, which has not been included in computing Federal taxable income, *including interest on State and Municipal bonds and certain obligations of the United States and its instrumentalities. . . .* (emphasis added)

the net worth base of the Corporation Business Tax Act was in fact as well as in name a franchise tax. Nevertheless, they argue that that case is now inapposite because the addition of the net income base transformed the CBT from a franchise tax to an income tax. This argument ignores the fact that the United States Supreme Court noted in *Werner Machine*: "This Court has consistently upheld franchise taxes measured by a yardstick which includes tax-exempt *income* or *property*, even though a part of the economic impact of the tax may be said to bear indirectly upon such income or property." 350 *U.S.* at 494, 100 *L.Ed.* at 637 (citations omitted) (emphasis added).[5] Hence, the rationale of *Werner Machine*, which upheld the inclusion of the principal of federal obligations in the net worth base, applies equally to uphold the inclusion of the interest income from such obligations in the net income base. The CBT is no more a direct tax upon a corporation's net income than upon its net worth. In both instances the bases are utilized merely as measures of the franchise tax.

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[5]The two cases most directly on point are mentioned in the annotation immediately following *Werner Machine:*

> See *Pacific Co. v. Johnson* (1932) 285 US 480, 76 L ed 893, 52 S Ct 424 (upholding franchise tax upon entire net income of corporation, including that from tax-exempt municipal bonds), and *Tradesmens Nat. Bank v. Oklahoma Tax Com.* (1940) 309 US 560, 84 L ed 947, 60 S Ct 688 (upholding state franchise tax on national banking association, measured by association's net income including tax-exempt income from federal securities). In both of these cases the nondiscriminatory nature of the tax was held to bar any finding of invalidity.
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> [Annotation, *State taxation of federal securities and obligations—federal cases*, 100 *L.Ed.* 637, 638 (1956).]

Furthermore, we have observed that "[t]he income tax portion was added as simply another element of the 1945 franchise tax, to provide an increase in the State's revenues. . . ." *F.W. Woolworth Co. v. Director, Division of Taxation,* 45 *N.J.* 466, 473 (1965). Similarly, we have stated that "[t]he net income measure of the tax, as another element in addition to net worth, was inserted by *L.* 1958, *c.* 63, pursuant to the recommendation of the *Ninth Report of the Commission on State Tax Policy* (1958)." *Roadway Express, Inc. v. Director, Division of Taxation,* 50 *N.J.* 471, 485 (1967), app. dism. 390 *U.S.* 745, 20 *L.Ed.*2d 276 (1968). "The essential purpose," we continued, "was to provide an increase in the state's revenues." *Id.* The essential purpose hence was not to change the conceptual nature of the tax, which the Legislature continues to dub an "annual franchise tax," *N.J.S.A.* 54:10A-5, to an income tax.[6]

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[6]GTC and *Amici* claim that in *Roadway Express* we recognized that the so-called franchise tax calculated in part on the basis of net income had "all the attributes of a direct levy on income" and therefore that that case requires the conclusion that the CBT as it presently exists is not a franchise tax. The relevant passage in *Roadway Express* needs to be read in context:

> The essential purpose was to provide an increase in the state's revenues. It may be surmised that historical antipathy in New Jersey to an income tax as such led to inclusion of it rather as another element of the franchise tax, although *otherwise it has all the attributes of a direct levy on income.*
>
> [50 *N.J.* at 485.]

To have all the attributes of a direct levy on income, however, is not the same as *otherwise* to have all the attributes of a direct levy on income. Compare this Court's remark in *Household Finance Corp. v. Director of Division of Taxation,* 36 *N.J.* 353, 358, app. dism., 371 *U.S.* 13, 9 *L.Ed.*2d 49 (1962): "While the "excise tax may gather the hue of a property tax . . . it is the

(Continued on next page)

In sum, we conclude that the CBT always has been and still is an annual franchise tax. The holding and implications of *Werner Machine* retain their vitality through recent decisions of both this Court and the United States Supreme Court. *See American Bank and Trust Co. v. Dallas*, 463 *U.S.* 855, 77 *L.Ed.*2d 1072 (1983); *Memphis Bank & Trust Co. v. Garner*, 459 *U.S.* 392, 74 *L.Ed.*2d 562 (1983). Therefore, *inclusion* of the face value and interest

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(Continued from previous page)

franchise to do local business that is being valued rather than any specific piece of property devoted to it." (quoted in *Motor Finance Corp. v. Director, Division of Taxation*, 129 *N.J. Super.* 19, 23 (App. Div. 1974)). A franchise tax that gathers the hue of, or otherwise has the attributes of, an income tax is not *ipso facto* an income tax. *Silent Hoist & Crane Co. v. Director, Division of Taxation*, 100 *N.J.* 1, 12 (1985), despite its overemphasis, is only apparently to the contrary ("In essence, the [net income measure] is a corporate income tax, although at the time [of its addition] denominated a franchise tax due to a surmised 'historical antipathy in New Jersey to an income tax as such.'" (quoting *Roadway Express*, 50 *N.J.* at 485)). At the time *F.W. Woolworth* and *Roadway Express* were decided, New Jersey imposed no general direct personal or corporate tax measured by or levied upon income. Since then, the Legislature has enacted a Corporate Income Tax (CIT). *N.J.S.A.* 54:10E-1 to -24. This undercuts the claim that the CBT is no longer a franchise tax but instead an income tax.

Moreover, the fact that the threshold activities by corporations triggering the imposition of the CBT, or the privileges that constitute the incidence of the tax, are the same today as they were when *Werner Machine* was decided confirms that the CBT remains a franchise tax.

Finally, when Congress adopted the present Federal Public Debt Statute, § 3124, P.L. 97-258, Sept. 13, 1982, quoted *supra* at note 2, it was well aware that many states, like New Jersey, calculate their corporation franchise taxes on the basis of net income. Yet Congress retained the exception for nondiscriminatory franchise taxes without eliminating such state taxes from its reach.

income of federal obligations in the bases for calculating the CBT does not by its own force violate the Federal Public Debt Statute. However, this statute also requires that the franchise tax be "nondiscriminatory" in order for the federal obligations to be included in these tax bases. And so, the federal statute allows inclusion of the principal and income from federal obligations only if the state enabling legislation likewise permits *inclusion* of the principal and income from state obligations. *Memphis Bank & Trust Co.*, 459 *U.S.* at 397-98, 74 *L.Ed.*2d at 567-68; *Werner Machine*, 350 *U.S.* at 493-94, 100 *L.Ed.* at 637. If the state enabling legislation requires *exclusion*, then the admittedly *bona fide* franchise tax would be impermissibly discriminatory. Our next inquiry, therefore, is whether the state enabling legislation requires exclusion or inclusion.

GTC and *Amici* contend that the state enabling statutes for the state and local bonds relevant here unequivocally exempt the principal and income of state obligations from inclusion in the bases for calculating the CBT. GTC offers the following exemption, applicable to bonds issued by local boards of education, as one typical example:

> Any and all bonds issued pursuant to this act shall be conclusively deemed to be governmental obligations for governmental and public purposes, and the same, together with any interest thereon, *shall be forever exempt from any and every tax* and *shall be excluded from the calculation of any and every tax, whenever enacted, of whatever nature and however levied, assessed or calculated,* whether during the lifetime or at or after or by reason of the death of any holder.
>
> [*N.J.S.A.* 18A:24-80 (emphases added).]

Similarly, *Amici* offer the following exemption, applicable to bonds issued by the New Jersey Economic Development

Authority (EDA), as "exemplary of the enabling statutes generally": "free from taxation of every kind by the State except for transfer, inheritance and estate taxes . . . ." *N.J.S.A.* 34:1B-15.

Despite the language of enabling statutes such as *N.J.S.A.* 18A:24-80 and *N.J.S.A.* 34:1B-15, the Director consistently has required corporations to include in their bases for computing franchise taxes the principal and interest income derived from (otherwise) tax exempt obligations issued by state authorities. *See N.J.A.C.* 18:7-5.2(a)(2), quoted *supra* note 5.[7] The Attorney General of New Jersey corroborated the Director's policy in Formal Opinion 7 (1977), advising the Department of Labor and Industry: "Pursuant to the principle established in the *Werner Machine* case, the principal of EDA bonds [issued under *N.J.S.A.* 34:1B-15] should be reflected in the net worth base of the [CBT] [and] the interest income and gain derived from the transfer of EDA bonds should be reflected in the net income tax base of the [CBT] . . . ." The Formal Opinion reasoned that:

> In construing a statute, it is to be assumed that the Legislature is familiar with its own enactments and the judicial and administrative interpretations thereof. *Barringer v. Miele,* 6 *N.J.* 139, 144 (1951). The failure of the Legislature to specifically exempt franchise taxes in its enactment of *N.J.S.A.* 34:1B-15 is a significant indication of legislative intent. It is persuasive that the Legislature did not intend to qualify the principle enunciated in *Werner Machine* and the

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[7]Likewise, the Director consistently has required corporations to include in the CBT tax bases the principal and interest income derived from federal obligations otherwise exempted from taxation.

> administrative implementation of these statutes by the Division of Taxation as it relates to the EDA bonds. Thus, the exemption established by *N.J.S.A.* 34:1B-15 clearly does not affect the imposition of the tax on the value, income and gain on transfer of EDA bonds under the corporation business tax and on the gain derived from the transfer of EDA bonds under the savings institution tax.
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> [Formal Opinion 7 at 6.]

The Tax Court, in affirming the Director's policy and the Attorney General's opinion, likewise relied upon the Legislature's acquiescence in the judicial and administrative interpretation of the Corporation Business Tax Act and the bond enabling statutes—especially its failure, against this background, to amend the enabling statutes specifically to exempt state and local obligations from inclusion in the CBT bases. 6 *N.J. Tax* at 471.

Amici urge though that the Legislature's failure to amend the EDA enabling statute is inconsequential, contending that the Legislature could have refused to amend it for a variety of reasons (including that the amendment was unnecessary because the statute already exempted EDA bonds from the CBT). This caveat against drawing inferences from legislative acquiescence might be compelling were this a case where the Legislature had given no consideration whatsoever to this issue. However, opponents of the Director's policy and the Attorney General's opinion twice have introduced an amendment to the EDA enabling statute whose express purpose was to overrule them (and thus to enact the interpretation advocated here by GTC and *Amici*), each time without success. Senate Bills 952

(1980) and 565 (1982).[8] The stricture against drawing inferences one way or another from legislative acquiescence in judicial and administrative interpretation of legislative enactments atrophies with every such unsuccessful introduction.

This acquiescence has been manifested not only in the Legislature's failure to amend the EDA enabling statute in the aftermath of Formal Opinion 7, but also in its decision to amend the Savings Institution Act to bring it into line with the Attorney General's advisements as to the implications of *Werner Machine* for the interpretation of the Corporation Business Tax Act. The previous provisions of the Savings Institution Tax Act, *L.* 1973, *c.* 31, were described as follows:

> Net income under that statute, although broadly defined to include income from all sources as well as gains derived from the sale of capital assets (N.J.S.A. 54:10D-2(d)), *specifically excludes* interest or dividends derived from obligations issued by the State of New Jersey or its authorities. N.J.S.A. 54:10D-2(d)(1)(b)(i). This provision *clearly exempts* the interest income from the EDA bonds from being included in the net income tax base of the savings institution tax. The savings institution tax, however, does not exclude profits derived from the sale of such obligations from being reflected in its tax base.
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> [Formal Opinion 7 at 4 (emphases added).]

The Attorney General advised that "[t]he interest income derived from EDA bonds *should not* be included in the net

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[8]Similar amendments (Senate Bills 6951 (1980) and 561 (1982)) were proposed with regard to the exemption accorded to bonds issued under *N.J.S.A.* 26:21-16 of the New Jersey Health Care Facilities Financing Authority Law, *N.J.S.A.* 26:21-1 to -39. These proposed amendments likewise were not adopted.

income tax base of the savings institution tax under the specific provisions of that statute." *Id.* at 7 (emphases added). At the same time, he advised that the interest income derived from EDA bonds *should* be included in the net income tax base of the corporation business tax, since the latter statute lacked a counterpart to the former's specific exemption and moreover was governed by *Werner Machine*.

The Legislature responded to this part of Formal Opinion 7 by deleting the provision specifically excluding interest income generated by the EDA bonds from the net income tax base for calculating the savings institution tax. It explained the amendment as follows:

> This bill would amend the Savings Institution Tax Act to meet the objections raised by a recent opinion of the Attorney General of New Jersey that the present law violates the Federal Public Debt Statute in discriminating against the United States Treasury obligations. To avoid such taxation [sic: discrimination], this bill would include, in a tax base, income from both Federal and State obligations . . . . [Introductory Statement, Assembley, No. 3326—*L.* 1979, *c.* 160.]

The Legislature's failure to enact Senate Bills 952 (1980) and 565 (1982), together with its action in amending the Savings Institution Tax Act, conclusively establishes that the Legislature intended to include in the CBT bases the principal of and interest income from state obligations. For in amending the Savings Institution Tax Act, the Legislature implicitly accepted the Formal Opinion's advisement as to inclusion of interest income in the net income base for corporation business tax purposes. Moreover, the Savings Institution Tax Act's original specific

exemption of interest income generated by state obligations from the net income tax base shows that the Legislature knows how to make this sort of specific exemption when it intends to do so; the absence of a counterpart specific exemption in the Corporation Business Tax Act suggests that the Legislature did not intend such an exemption. This suggestion is confirmed by the Legislature's action in response to Formal Opinion 7, which was not to *adopt* a specific exemption in the latter statute but to *delete* the specific exemption in the former.

Furthermore, the Legislature took this action avowedly to avoid violating the Federal Public Debt Statute (as interpreted in *Werner Machine*) by discriminating in favor of state obligations and against federal obligations, thereby running afoul of the Supremacy Clause of the United States Constitution. This supports the soundness of the Tax Court's invocation of the basic principle of statutory construction that

> [e]ven though a statute may be open to a construction which would render it unconstitutional or permit its unconstitutional application, it is the duty of this Court to so construe the statute as to render it constitutional if it is reasonably susceptible to such interpretation.
>
> [6 *N.J. Tax* at 472 (quoting *State v. Profaci,* 56 *N.J.* 346, 350 (1970)).]

Discharging this duty, we, like the Tax Court, interpret the state enabling legislation not to exclude state obligations from the CBT bases.

Our interpretation likewise comports with the principle that tax exemptions are to be strictly construed.[9] This principle, unquestionably applicable to tax exemptions that are part of an overall tax statute, applies *a fortiori* to exemptions that are part of bond enabling statutes--for in enacting an overall tax statute, the Legislature is likely to be more cognizant of the general rules from which it must clearly state specific exemptions than it is in enacting enabling statutes for state and local debt obligations.

Finally, this interpretation harmonizes the statutory provision requiring that "[e]ntire net income shall be determined without the exclusion . . . of [a]ny income from dividends or interest on any kind of stock, securities or indebtedness . . . ." (*N.J.S.A.* 54:10A-4(k)(2)) with the enabling legislation exempting state and local debt obligations from "taxation of every kind . . . ." (*N.J.S.A.* 34:1B-15). The words "taxation of every kind" by themselves no more "plainly" dispose of the questions presented in this case than do the words "any kind of stock, securities or indebtednes," nor than did the words "shall be exempt from taxation" in the original Federal Public Debt Statute prior to *Werner Machine*. As between a general rule forbidding exclusion (*N.J.S.A.* 54:10A-4(k)(2)) and a general exemption requiring exclusion (*N.J.S.A.* 18A:24-80 and *N.J.S.A.* 34:1B-15), the latter must bear the burden of clearly stating a specific exemption—all the more so

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[9]Moreover, our interpretation is in keeping with the Legislature's concern to protect its revenue base, which was evinced both in its amendment of the Savings Institution Tax Act and its failure to amend either the Corporation Business Tax Act or the EDA bond enabling statute. We deny the motion of *Amici* to strike certain portions of the oral argument of respondent.

against the background of the judicial and administrative interpretation of the basic provisions of the Corporation Business Tax Act. The Legislature has not clearly stated such a specific exemption here.

In short, we hold that these sound principles of statutory construction likewise support our conclusion that the Legislature intended to require the inclusion of the principal and interest income of state and local obligations in the net worth and net income bases for calculating the corporation business tax.

IV

We have concluded that the Federal Public Debt Statute by its own force does not exempt the principal and interest income of federal obligations from inclusion in the net worth and net income bases for computing the CBT, and that the state enabling legislation does not exempt the principal and interest income of state obligations from inclusion in the CBT bases. And we have observed that both federal and state obligations consistently have been included in these bases. The term "nondiscriminatory" in the Federal Public Debt Statute pertains to the treatment for tax purposes of federal obligations as compared with state obligations. *Memphis Bank & Trust Co. v. Garner,* 459 *U.S.* at 397-98, 74 *L.Ed.*2d at 567-68; *Werner Machine,* 350 *U.S.* at 493-94, 100 *L.Ed.* at 637. We therefore hold that the corporation business tax is not only a *bona fide* franchise tax, but also a ***nondiscriminatory*** franchise tax.

Accordingly, we affirm the judgment of the Appellate Division.

For affirmance—Justices CLIFFORD, HANDLER, O'HEARN, GARIBALDI and STEIN—4.

For reversal—none.

NOT FOR PUBLICATION WITHOUT THE APPROVAL OF THE COMMITTEE ON OPINIONS

SUPERIOR COURT OF NEW JERSEY
APPELLATE DIVISION A-5620-83T7

GARFIELD TRUST COMPANY,

Plaintiff-Appellant,

v.

DIRECTOR, DIVISION OF TAXATION,

Defendant-Respondent.

Argued June 4, 1985 — Decided June 12, 1985

Before Judges Pressler, Brody and Cohen.

On Appeal from the Tax Court of New Jersey, opinion reported at 6 *N.J. Tax* 462 (1984).

Glenn T. Leonard argued the cause for appellant (Checki & Politan, attorneys).

Harry Haushalter argued the cause for respondent (Irwin I. Kimmelman, Attorney General, attorney; James J. Ciancia, Assistant Attorney General, of counsel).

William S. Robertson, III argued the cause for the *amici curiae,* Summit & Elizabeth Trust Co., New Jersey National Bank, The Ramapo Bank, Pilgrim State Bank, The Chatham Trust Co., Maplewood Bank & Trust Co., Ocean County National Bank, Amboy-Madison National Bank and The Town & Country Bank (Williams, Caliri, Miller & Otley, attorneys; Mr. Robertson, Bruce K. Adler and Carol A. Burns, on the brief).

(Filed June 12, 1985)

PER CURIAM

Plaintiff and various *amici curiae* challenge inclusion in the tax bases of state and federally chartered commer-

cial banks, for the purpose of the New Jersey Corporate Business Tax, of the value of federal, state and local obligations and the income therefrom. After losing in the Tax Court, they appealed here. We are completely satisfied with the determination of the Tax Court and therefore affirm substantially for the reasons expressed by Judge Richard M. Conley in his opinion, reported at 6 *N.J. Tax* 462 (1984).

TAX COURT OPINION DECIDED: JUNE 19, 1984
TAX COURT OF NEW JERSEY
DOCKET NO. CB 143A-80

GARFIELD TRUST COMPANY,

Plaintiff,

v.

DIRECTOR, DIV. OF TAXATION,

Defendant.

Decided June 19, 1984

SYNOPSIS

Taxpayer bank filed complaint seeking to have Director of Division of Taxation ordered to refund some or all of the tax payment under the Corporation Business Tax Act. The Tax Court, Conley, J.T.C., held that: (1) state's inclusion of federal obligations in taxpayer bank's tax bases under the Corporation Business Tax Act complied with the federal public debt statute since tax was nondiscriminatory, and (2) taxpayer bank's net worth and net income tax bases appropriately included value of and income from bank's holdings of state and local obligations.

Affirmed.

Glenn T. Leonard for plaintiff
(Checki and Politan, attorneys).

Harry Haushalter for defendant
(Irwin I. Kimmelman, Attorney General
of New Jersey, attorney).

CONLEY, J.T.C.

This litigation involves the 1977 corporation business tax liability of a commercial banking corporation char-

tered by the State of New Jersey. The New Jersey Corporation Business Tax Act (1945) has imposed an annual franchise tax on banking corporations since 1976. *N.J.S.A.* 54:10A-34; *L.* 1975, *c.* 170, § 4.* The amount of a taxpayer's corporate business tax liability is determined by the addition of prescribed percentages of net worth and net income allocable to this State. *N.J.S.A.* 54:10A-4(d) and (k) and *N.J.S.A.* 54:10A-5.

When plaintiff computed its tax liability under these provisions it included its holdings of federal obligations in its net worth tax base and it included income from the same securities in its net income tax base. Most of plaintiff's federal obligations were U.S. Treasury bonds and notes. After paying the tax plaintiff filed a refund claim. The bank's position is that a federal statute proscribes any state taxation of federal obligations and that New Jersey's taxation of the bank's federal holdings is therefore barred by the supremacy clause of the Constitution of the United States. *U.S. Const.*, Art. VI, par. 2. The Director of the Division of Taxation denied plaintiff's refund claim and the bank filed a complaint in this court seeking to have the Director ordered to refund some or all of plaintiff's tax payment. For the reasons set forth below, I hold that the denial of plaintiff's refund claim was correct because the corporation business tax liability of commercial banks may be calculated based on their ownership of and income from obligations of the federal government.

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*Prior to 1976 commercial banks were subject to a state tax on their capital stock. *N.J.S.A.* 54:9-1 *et seq.* The bank stock tax was repealed by the same law that amended the Corporation Business Tax Act. *L.* 1975, *c.* 170, § 3.

The congressional enactment that plaintiff relies upon as barring the state taxation of federal obligations is sometimes referred to as the Federal Public Debt Statute, 31 *U.S.C.A.* § 3124 (formerly 31 *U.S.C.A.* § 742). In its earlier form that statute was as follows:

> Except as otherwise provided by law, all stocks, bonds, Treasury notes and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. [31 *U.S.C.A.* § 742]

In *Werner Machine Co. v. Taxation Div. Director,* 350 *U.S.* 492, 76 *S.Ct.* 534, 100 *L.Ed.* 634 (1956), the Supreme Court of the United States considered the impact of that statutory provision on a New Jersey corporation business tax assessment based in part on the inclusion of the value of certain federal bonds in the corporation's net worth calculation. The Court affirmed the conclusion of the New Jersey Supreme Court that the corporation business tax was "a bona fide franchise tax" imposed on a corporation for the privilege of having or exercising its corporate franchise in the State, not a tax imposed directly on the property held by the corporation. *Id.* 350 *U.S.* at 493. The Court held:

> Since the tax remains the same whatever the character of the corporate assets may be, no claim can be sustained that this taxing statute discriminates against the federal obligations. And since this is a tax on the corporate franchise, it is valid despite the inclusion of federal bonds in the determination of net worth. This Court has consistently upheld franchise taxes measured by a yardstick which includes tax-exempt income or property, even though a part of the economic impact of the tax may be said to bear in-

> directly upon such income or property. [*Id.* 350 *U.S.* at 493-494]

In 1959, after the decision in *Werner Machine Co.*, Congress amended the Federal Public Debt Statute by adding a second sentence. The statutory language in effect for 1977 was as follows:

> Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, *except nondiscriminatory franchise* or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes. [31 *U.S.C.A.* § 742; emphasis supplied]

Plaintiff contends that this version of 31 *U.S.C.A.* § 742 changed the law dealt with in *Werner Machine Co.* by prohibiting the inclusion of plaintiff's federal obligations in its tax bases for corporation business tax purposes. Plaintiff relies in large measure for this proposition on a recent decision by the Supreme Court of the United States, *American Bank and Trust Company v. Dallas County*, — *U.S.* —, 103 *S.Ct.* 3369, 77 *L.Ed.*2d 1072 (1983). In that case the Court held that a Texas property tax on bank shares, computed on the basis of the bank's net assets without any deduction for tax-exempt United States obligations held by the bank, was violative of 31 *U.S.C.A.* § 742. According to plaintiff, the Court in *Dallas County* abandoned the "highly formalistic" distinction between taxes directly

on as opposed to taxes measured by government securities that it had articulated in the *Werner Machine Co.* case.

Contrary to plaintiff's characterization of the *Dallas County* opinion, however, the Court reaffirmed the distinction between nondiscriminatory franchise taxes measured by tax-exempt obligations and property taxes imposed directly on shares of bank stock. The Court stated:

> Prior to the 1959 amendment, franchise and estate and inheritance taxes measured by the value of federal obligations, like bank shares taxes, were upheld on the theory that the tax was levied on the franchise or the transfer of property, rather than on the ownership interest in the federal securities themselves. By expressly exempting franchise and estate and inheritance taxes from the amended [§ 742], Congress manifested its awareness that the new language would broaden significantly the prohibition as it had been construed by the courts. Congress must have believed that franchise and estate and inheritance taxes required federal obligations to "be considered, directly or indirectly, in the computations of the tax"; otherwise, the specific exemptions for these taxes would have been superfluous. There is no reason to conclude that shares taxes are any different. [77 *L.Ed.*2d 1079-1080]

Thus, the Court recognized that although franchise taxes require federal obligations to be considered in the computation of the tax contrary to the general focus of § 742, Congress carved out a specific exception to that statute for non-discriminatory franchise taxes. The Court made the distinction explicit in analyzing the legislative history of the amendment by quoting from both the Senate and House Reports as follows:

> . . . the [1959] amendment "makes it clear that both the principal and interest on U.S. obligations are

> exempt from *all State taxes except nondiscriminatory franchise,* etc., *taxes*" . . . S Rep No. 909, 86th Cong., 1st Sess., 2 (1959); HR Rep No. 1148, 86th Cong., 1st Sess., 2 (1959). Congress intended to sweep away formal distinctions and to invalidate all taxes measured directly or indirectly by the value of federal obligations, except those specified in the amendment." [77 *L.Ed.*2d 1082; emphasis supplied in part]

It is apparent from the *Dallas County* case that the distinction between nondiscriminatory franchise taxes and taxes imposed directly on government obligations still exists and is very significant in terms of compliance with the Federal Public Debt Statute. However, the distinction is no longer based on a "formalistic' 'analysis by the Supreme Court. Rather, it is based on an express enactment of the Congress. Thus, the State's inclusion of federal obligations in plaintiff's tax bases under the Corporation Business Tax Act complies with the Federal Public Debt Statute as long as New Jersey's tax is nondiscriminatory.

The term "nondiscriminatory" as used by Congress in 31 *U.S.C.A.* § 742 pertains to the treatment for tax purposes of federal obligations as compared with state obligations. The Supreme Court made this clear only last year in *Memphis Bank & Trust Company v. Garner,* — *U.S.* —, 103 *S.Ct.* 692, 74 *L.Ed.*2d 562 (1983). The Court said:

> A state tax that imposes a greater burden on holders of federal property than on holders of similar state property impermissibly discriminates against federal obligations. See e.g. *United States v. County of Fresno, supra* at 462, 50 *L.Ed.*2d 683, 97 *S.Ct.* 699 ("a state tax on those who deal with the Federal Government" is unconstitutional if the tax "is imposed [un]equally on similarly situated constituents of the State"). Our cases establish, however, that if the "tax remains the

> same whatever the character of the [property] may be, no claim can be sustained that this taxing statute discriminates against federal obligations." *Werner Machine Co. v. Director of Division of Taxation, supra,* at 492, 100 *L.Ed.* 634, 76 *S.Ct.* 534 (1956). [*Id.* 74 *L.Ed.*2d at 567-568]

Since federal and state obligations have continuously been included in a corporation's net worth and net income tax bases under the Corporation Business Tax Act, as the parties have stipulated, the act is nondiscriminatory within the intent of 31 *U.S.C.A.* § 742 as construed by the Supreme Court.

Even though the act is nondiscriminatory as that term is used in the Federal Public Debt Statute, plaintiff argues that the treatment of commercial banks under the act was discriminatory in 1977 under the Equal Protection Clause of the United States Constitution. The premise for this contention is that in 1977 commercial banks such as plaintiff were required to include interest from both federal and state obligations in their franchise tax base while competing financial institutions were not required to do so to the same extent.

In 1977, New Jersey savings banks, building and loan associations, and savings and loan associations were subject to an annual franchise tax pursuant to the Savings Institution Tax Act, *N.J.S.A.* 54:10D-1 *et seq.* Until it was amended by *L.* 1979, *c.* 160 §1, effective January 1, 1979, the latter act did not require the inclusion in a taxpayer's tax base of income from any state or federal obligations. Based on an opinion of the Attorney General of New Jersey, income from Federal National Mortgage Association notes was includible because they were not fed-

eral obligations. According to the introductory statement to the bill which was enacted as *L.* 1979, *c.* 160, the law was amended to bring it into compliance with the Federal Public Debt Statute by including income from both federal and state obligations in the tax base, thereby eliminating any potential discrimination against federal obligations.

However, the possible existence of a defect in the Savings Institution Tax Act prior to 1979 has no bearing on the constitutionality of the Corporation Business Tax Act in 1977. The constitutionality of the latter act in the context of an equal protection challenge depends upon whether it was reasonable for the Legislature to distinguish between commercial banks and competing financial institutions in matters of taxation. Stated another way, "the crucial constitutional issue is whether there is any reasonably conceivable state of facts which would afford a rational basis for the classification" of financial institutions. *See McKenney v. Byrne,* 82 *N.J.* 304, 316 (1980).

The answer to this inquiry is readily apparent. The Legislature has consistently classified commercial banks differently for all purposes. Both savings and loan associations and building and loan associations are established and governed pursuant to the Savings and Loan Act (1963), *N.J.S.A.* 17:12B-1 *et seq.* Commercial banks and savings banks are established and governed pursuant to the Banking Act of 1948, *N.J.S.A.* 17:9A-1 *et seq.* According to the terms of that statute savings banks have less extensive powers than commercial banks. In *Tri-County Savings and Loan Assoc. v. Banking Commissioner,* 170 *N.J. Super.* 576 (App. Div. 1979), certif. den. 82 *N.J.* 286 (1980), the court considered the scope of the investment powers granted to

savings and loan associations by the Legislature. The court observed that:

> . . . while commercial banks are given broad powers to invest in and otherwise deal with the virtual gamut of debt obligations, including time sales contracts, savings banks do not have such powers but are limited to investment in "installment loans" in the narrowest sense of those terms. . . . Since savings banks cannot invest in or deal in time sales contracts, savings and loan associations cannot do so either. [170 *N.J. Super.* at 583]

The court further stated:

> In short, there is no indication that the Legislature ever intended to make savings banks (and by extrapolation savings and loan associations) virtually identical to, as opposed to merely competitive with, commercial banks. [*Id.* at 584]

This different treatment of commercial banks evidences a state of facts known to the Legislature that affords a rational basis for the taxation of commercial banks on a basis different from that of other financial institutions. *McKenney v. Byrne, supra.* Thus, plaintiff's contention on this point has no merit.

Plaintiff's next argument concerns the taxability of state and local obligations. In 1976, plaintiff held bonds of the N.J. Educational Facilities Authority, the N.J. Health Facilities Authority, the N.J. Housing Finance Agency, the N.J Mortgage Finance Agency Rutgers the State University, and of numerous New Jersey counties, municipalities boards of education and sewer authorities. Since the various state and local bonds were issued pursuant to enabling legislation that declared income from them to be tax exempt, as is the case with federal obligations, plaintiff contends in its trial brief that its holdings of state and local

obligations should not be considered as part of its tax bases under the Corporation Business Tax Act.

Plaintiff did not allege in its complaint nor preserve as an issue in the pretrial order that its assessment should not have been based on the inclusion of state and local bonds or the income from them. Nonetheless, both parties addressed this issue in their briefs and I will deal with it because it is an actual dispute between parties who have a significant stake in the outcome. *Cf. N.J. Assoc. for Retarded Citizens v. Human Services Department*, 89 *N.J.* 234, 241 (1982); *Logistics Industries Corp. v. Taxation Div. Director*, 2 *N.J. Tax* 484, 488-489 (Tax Ct. 1981).

One typical example of the various provisions in enabling legislation relied on by plaintiff is the following, applicable to bonds issued by local boards of education:

> Any and all bonds issued pursuant to this act shall be conclusively deemed to be governmental obligations for governmental and public purposes, and the same, together with any interest thereon, shall be forever exempt from any and every tax and shall be excluded from the calculation of any and every tax, wherever enacted, of whatever nature and however levied, assessed or calculated, whether during the lifetime or at or after or by reason of the death of any holder. [*N.J.S.A.* 18A:24-80]

Despite such language, the Director has consistently required corporations to include both federal and state obligations in their tax bases for corporation business tax purposes. See *N.J.A.C.* 18:7-5.2(a)(2). The Attorney General has corroborated the Director's policy in a formal opinion stating that bonds of the Economic Development Authority which were otherwise exempt were includible in a taxpayer's tax bases for corporation business tax purposes.

Att. Gen., Formal Op. 7 (1977). The enabling legislation for EDA bonds is substantially the same as it is for local board of education bonds. See *N.J.S.A.* 34:1B-15. The most significant difference between the two provisions is that *N.J.S.A.* 34:1B-15 states that the obligations issued pursuant to its authority shall "be free from taxation of every kind by the State *except for transfer, inheritance, and estate taxes. . . .*" [emphasis supplied].

In examining whether income from such bonds was includible in a corporation's net income tax base within the intent of the Corporation Business Tax Act, the Attorney General concluded that:

> In construing a statute, it is to be assumed that the Legislature is familiar with its own enactments and the judicial and administrative interpretation thereof. *Barringer v. Miele*, 6 *N.J.* 139, 144 (1951). The failure of the Legislature to specifically exempt franchise taxes in its enactment of *N.J.S.A.* 34:1B-15 is a significant indication of legislative intent. It is persuasive that the Legislature did not intend to qualify the principle enunciated in *Werner Machine* and the administrative implementation of these statutes by the Division of Taxation as it relates to the EDA bonds. Thus, the exemption established by *N.J.S.A.* 34:1B-15 clearly does not affect the imposition of the tax on the value, income and gain on transfer of EDA bonds under the corporation business tax. . . .

The Legislature has never amended any of the enabling acts cited by plaintiff to provide expressly that its intent was to exempt the various state and local obligations from inclusion in corporation business tax bases. In fact, bills to accomplish just such an amendment have not been adopted. Senate Bills No. 952 (1980) and No. 565 (1982). A strong inference may therefore be drawn that the At-

torney General's formal opinion is consistent with legislative intent. *State v. Son*, 179 *N.J. Super.* 549, 553 (App. Div. 1981).

More importantly, if the enabling legislation were construed to prohibit inclusion of these obligations in corporation business tax bases, a serious constitutional question would arise. If the State and local obligations were not includible but Federal obligations were, the Corporation Business Tax Act might well be said to discriminate in favor of State obligations and against Federal obligations in violation of the Federal Public Debt Statute and thus of the Supremacy Clause of the United States Constitution.

Given this potential constitutional problem, a basic principle of statutory construction becomes very significant. This principle is that

> [e]ven though a statute may be open to a construction which would render it unconstitutional or permit its unconstitutional application, it is the duty of this Court to so construe the statute as to render it constitutional if it is reasonably susceptible to such interpretation. [*State v. Profaci*, 56 *N.J.* 346, 350 (1970)].

It is certainly reasonable to construe the various enabling act provisions as the Attorney General has done. His construction is in keeping with another well-recognized principle, that exemptions from taxation are strictly construed. *Container Ring Co. v. Taxation Div. Director*, 1 *N.J. Tax* 203, 208 (Tax Ct. 1980), aff'd 4 *N.J. Tax* 527 (App. Div. 1981). It is also in keeping with the State's desire to protect its revenue base, as was demonstrated when the Legislature amended the Savings Institution Tax

Act in 1979 to make it comport with the Federal Public Debt Statute. *Accord, National Bank of Alaska v. Alaska Dept. of Revenue,* 642 *P.*2d 811 (Alaska Sup. Ct. 1982); *Connecticut Bank and Trust Co. v. Tax Commissioner,* 178 *Conn.* 243, 423 *A.*2d 883 (Sup. Ct. 1979). I therefore hold that plaintiff's net worth and net income tax bases appropriately included the value of and the income from the bank's holdings of state and local obligations.

The final argument plaintiff raises is that the "save harmless" provision of the Corporation Business Tax Act is contrary to the Federal Public Debt Statute and thus unconstitutional under the Supremacy Clause. The save harmless provision provided for a minimum tax liability for commercial banks so that the State's revenue was not diminished in the transition to the corporation business tax from the bank stock tax, *N.J.S.A.* 54:9-1 *et seq.*, which was repealed when these banks became subject to the Corporation Business Tax Act. Under the save harmless formula for 1977, a bank was required to pay an amount equal to what it had paid in 1975 in bank stock tax unless its obligation under the new taxing scheme was greater. *N.J.S.A.* 54:10A-34. In effect, plaintiff's challenge is to the former bank stock tax as it is reflected in the save harmless provision of the Corporation Business Tax Act. However, it was stipulated that plaintiff's 1977 tax liability had been computed in accordance with the new amendments to the Corporation Business Tax Act. The save harmless provision of the act would have become operative only if the court had sustained plaintiff's allegations and eliminated federal obligations from the bank's tax bases. Since plaintiff has not prevailed in any of its several attacks on the constitutionality of the Corporation

Business Tax Act, the issue involving the save harmless provision is moot and will not be addressed.

The Director's denial of plaintiff's refund claim is therefore affirmed in all respects.

SUPREME COURT OF NEW JERSEY
A-85 September Term 1985

GARFIELD TRUST COMPANY,

Appellant,

v.

DIRECTOR, DIVISION OF TAXATION,

Appellee.

NOTICE OF APPEAL TO THE
SUPREME COURT OF THE UNITED STATES

(Filed Aug. 13, 1986)

NOTICE is hereby given that GARFIELD TRUST COMPANY, the appellant above-named hereby appeals to the Supreme Court of the United States from a portion of the Final Judgment of the Supreme Court of the State of New Jersey, entered in this action on May 22, 1986.

The Supreme Court of New Jersey construed the New Jersey Corporation Business Tax (CBT), *N.J.S.A.* 54: 10A-1 to -40, as a *bona fide* annual franchise tax, and concluded that the inclusion of the face value and interest income of federal obligations in the net asset and net income bases of the CBT for calculating such tax did not violate the Federal Public Debt Statute, 31 U.S.C. § 742 (1976), which forbids state and local authorities from taxing federal obligations or the income thereon. The Court concluded that the CBT fell within the exception to the Federal Public Debt Statute, 31 U.S.C. § 742 (1976), as a *bona fide* "franchise" tax.

The Court also construed the CBT and numerous independently enacted New Jersey state laws which provide broad exemption from state taxation for certain state and local governmental and agency obligations as not requiring the exclusion of the principal and interest income of such state obligations from the CBT bases. The Court therefore concluded that the CBT was not only a *bona fide* "franchise" tax but also a *nondiscriminatory* franchise tax within the meaning of such exception to 31 U.S.C. § 742 (1976).

The Appellant hereby appeals to the Supreme Court of the United States that portion of the Final Judgment of the Supreme Court of New Jersey which affirmed the judgment of the Superior Court of New Jersey, Appellate Division and which sustained the validity of the CBT as a *bona fide* "franchise" tax for purposes of the exception to 31 U.S.C. § 742 (1976) against Appellant's challenges that the inclusion of interest on federal obligations in the CBT's net income computational base, and the inclusion of the principal of such obligations in the CBT's net asset computational base, violated federal law and are repugnant to the Borrowing and Supremacy Clauses of the United States Constitution.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Respectfully submitted,

/s/ Glenn T. Leonard

CECCHI AND POLITAN
34 Park Avenue
P.O. Box 158
Lyndhurst, New Jersey 07071
(201) 939-1550

Attorneys for Appellant

CERTIFICATE OF SERVICE

I, Glenn T. Leonard, do hereby certify that a copy of the foregoing Notice of Appeal to the Supreme Court of the United States has been served on Appellee by hand delivering a copy thereof to:

HARRY HAUSHALTER, ESQ.
Deputy Attorney General of New Jersey
Assistant Section Chief
Department of Law and Public Safety
Division of Law
Financial Section
Richard J. Hughes Justice Complex
CN 112
Trenton, N.J. 08625
Attorney for Appellee,
Director, Division of Taxation

this 13th day of August, 1986.

/s/ Glenn T. Leonard

EXCERPTS—Public Debt Ceiling and Interest Rate Ceiling on Bonds: Hearings Before the House Committee on Ways and Means, 86th Cong., 1st Sess. 69-72, 82 (1959)

* * *

Section 5 of the bill would amend section 3701 of the Revised Statutes (31 U.S.C. 742) to clarify the exemption it accords to the interest on obligations of the United States from State and local income taxes.

Section 3701 of the Revised Statutes provides that obligations of the United States shall be exempt from taxation by or under State or local authority. The Supreme Court of the United States has held that this provision also exempts the interest on obligations of the United States from taxation by or under State or local authority (*N. J. Realty Title Ins. Co. v. Div. of Tax Appeals* (1950), 338 U.S. 665).

In recent years the State of Idaho has taken the position that its income tax law enacted in 1933 has required the inclusion of interest on obligations of the United States in computing gross income (from which taxable net income was determined), and that the Federal statutes have not precluded this requirement. The Idaho statute provided that there shall be levied "upon every individual . . . a tax which shall be according to and measured by his net income." The term "gross income" (from which taxable net income was determined) was defined to include, among other items, "all interest received from federal, state, municipal or other bonds." The law elsewhere provided, however, that "all income, except . . . income not permitted to be taxed under . . . the constitution or laws of the

United States, shall be included and considered in determining net income of taxpayers."

It has apparently been the position of the State of Idaho not that the Federal Government is without power to exempt the interest on its obligations from State income taxes, but rather that it has not exempted that interest from a tax such as the Idaho tax.

The reasoning of the Idaho authorities appears to have been as follows: The Federal statute has exempted the interest on Federal obligations from State taxation, and the State tax statute excluded income not permitted to be taxed by the Federal exempting statute, but the Idaho statute did not attempt to tax this income. Rather is carefully provided that there should be levied "upon every individual . . . a tax . . . measured by his net income." Apparently their position has been that this has a different effect from the State statute before 1933, which provided that there should be levied "upon the net income of every individual . . . a tax," which was therefore a tax not permitted under the Federal exempting statute.

The Treasury and the Department of Justice have felt that the position of the State of Idaho rests upon a distinction of words which is without substance. We have not, however, been able to persuade the Idaho authorities to change their position. Since this position does not rest upon a theory of lack of Congressional power to exempt interest on Federal obligations from a tax such as Idaho has had, but rather upon the theory that Congress has not exercised its power, the Treasury and the Department of Justice believe that the simplest resolution of the matter would be through Congressional action which would clarify

the exemption by expressly exempting Federal obligations and the interest on them from every form of State and local income taxes. The proposed provision would accomplish that purpose.

It should be mentioned that on March 20, 1959, the State of Idaho adopted a new income tax law. The new law declares it to be its intent to impose a tax identical as far as possible to the income tax imposed by the Federal Internal Revenue Code. Since the Federal Internal Revenue Code imposes a tax "on the taxable income of every individual" it has been suggested that Idaho may no longer attempt to maintain its position that the Federal exemption statute does not extend to its income tax. We have communicated with responsible State authorities, however, and have been unable to obtain assurances that the State will discontinue requiring the inclusion of interest on obligations of the United States in computing State income taxes.

PUBLIC DEBT AND INTEREST RATE CEILINGS

In these circumstances, we believe it to be highly desirable for the Congress to make the exemption statute more specific at this time. If positions such as Idaho has held are adopted by other States the resulting taxation could have a serious adverse effect on the sale of United States savings bonds, which are so widely held by individuals, and could have undesirable effects on Treasury financing operations in general.

* * *

PUBLIC DEBT AND INTEREST RATE CEILINGS

Section-by-section Analysis

of

A Bill to Facilitate Management of the Public Debt

Section 1 would remove the present limit of 4-¼ percent on the rate of interest on new issues of Treasury bonds.

Section 2 would provide a permanent increase in the debt limit to $288 billion and would provide for a temporary debt limit of $295 billion through June 30, 1960.

Section 3 would remove the present limit of 3.26 percent on the rate of interest on savings bonds, it would remove the present limits on maturities of savings bonds, it would authorize further extension of Series E savings bonds which have been authorized to earn interest after maturity, it would authorize similar extensions of Series H savings bonds, and it would authorize the increasing of interest rates upon Series E and H savings bonds after rates of interest have been fixed by contract.

Section 4 would relieve agents authorized to make payments in connection with the redemption of savings bonds from liability to the United States for erroneous payment unless written notice of potential liability is given within ten years from the date of the erroneous payment.

Section 5 would make it clear that present provisions of law exempting obligations of the United States from State and local taxation cover State income taxes.

New Jersey Corporation Business Tax Statutes

N.J.S.A. 54:10A-2. Franchise tax; annual payment in lieu of taxes upon intangible personal property; "doing business, employing or owning capital or property in state" defined

Every domestic or foreign corporation which is not hereinafter exempted shall pay an annual franchise tax for the year 1946 and each year thereafter, as hereinafter provided, for the privilege of having or exercising its corporate franchise in this State, or for the privilege of doing business, employing or owning capital or property, or maintaining an office, in this State. And such franchise tax shall be in lieu of all other State, county or local taxation upon or measured by intangible personal property used in business by corporations liable to taxation under this act but, whenever such corporation holds shares of stock in a bank as defined in R.S. 54:9-1, and such bank has not elected to have the taxable value of such shares assessed to it and to pay the tax levied against such shares as provided in R.S. 54:9-14, or, having made such election, such bank subsequently revokes it, the provisions of this section shall not exempt such shares of stock from the tax imposed by chapter 9 of Title 54 of the Revised Statutes.

A foreign corporation shall not be deemed to be doing business, employing or owning capital or property in the State, for the purposes of this act, by reason of (1) the maintenance of cash balances with banks or trust companies in this State, or (2) the ownership of shares of stock or securities in this State if such shares or securities are pledged as collateral security, or deposited with one or more banks or trust companies or brokers who are members of a recognized security exchange, in safekeeping or custody accounts, or (3) the taking of any action by such bank or

trust company, or broker, which is incidental to the rendering of safekeeping or custodian service to such corporation.

Amended by L.1973, c. 95, § 1.

N.J.S.A. 54:10A-4. Definitions

* * *

(d) "Net worth" shall mean the aggregate of the values disclosed by the books of the corporation for (1) issued and outstanding capital stock, (2) paid-in or capital surplus, (3) earned surplus and undivided profits, and (4) surplus reserves which can reasonably be expected to accrue to holders or owners of equitable shares, not including reasonable valuation reserves, such as reserves for depreciation or obsolence or depletion. Notwithstanding the foregoing, net worth shall not include any deduction for the amount of the excess depreciation described in paragraph (2)(F) of subsection (k) of this section. The foregoing aggregate of values shall be reduced by 50% of the amount disclosed by the books of the corporation for investment in the capital stock of one or more subsidiaries, which investment is defined as ownership (1) of at least 80% of the total combined voting power of all classes of stock of the subsidiary entitled to vote and (2) of at least 80% of the total number of shares of all other classes of stock except nonvoting stock which is limited and preferred as to dividends. In the case of investment in an entity organized under the laws of a foreign country, the foregoing requisite degree of ownership shall effect a like reduction of such investment from net worth of the taxpayer, if the foreign entity is considered a corporation for any purpose under the United States federal income tax laws, such as (but not by way of sole examples) for the purpose of supplying deemed paid foreign tax credits or for the purpose of status

as a controlled foreign corporation. In calculating the net worth of a taxpayer entitled to reduction for investment in subsidiaries, the amount of liabilities of the taxpayer shall be reduced by such proportion of the liabilities as corresponds to the ratio which the excluded portion of the subsidiary values bears to the total assets of the taxpayer.

In the case of banking corporations which have international banking facilities as defined in subsection (n), the foregoing aggregate of values shall also be reduced by retained earnings of the international banking facility. Retained earnings means the earnings accumulated over the life of such facility and shall not include the pro rata share of dividends paid and federal income taxes paid or payable during the tax year.

If in the opinion of the commissioner, the corporation's books do not disclose fair valuations the commissiner may make a reasonable determination of the net worth which, in his opinion, would reflect the fair value of the assets, exclusive of subsidiary investments as defined aforesaid, carried on the books of the corporation, in accordance with sound accounting principles, and such determination shall be used as net worth for the purpose of this act.

N.J.S.A. 54:10A-4. Definitions

* * *

(k) "Entire net income" shall mean total net income from all sources, whether within or without the United States, and shall include the gain derived from the employment of capital or labor, or from both combined, as well as profit gained through a sale or conversion of capital assets. For the purpose of this act, the amount of a taxpayer's entire net income shall be deemed prima facie to be equal in amount to the taxable income, before net operating loss de-

duction and special deductions, which the taxpayer is required to report to the United States Treasury Department for the purpose of computing its federal income tax; provided, however, that in the determination of such entire net income.

(1) Entire net income shall exclude 100% of dividends which were included in computing such taxable income for federal income tax purposes, paid to the taxpayer by one or more subsidiaries owned by the taxpayer to the extent of the 80% of more ownership of investment described in subsection (d) of this section. With respect to other dividends, entire net income shall not include 50% of the total included in computing such taxable income for federal income tax purposes. Entire net income shall exclude for the periods set forth in paragraph (2)(F)(i) of this subsection, any amount, except with respect to property described in section 168(f)(8)(D)(v) of the Internal Revenue Code[3] as in effect immediately prior to January 1, 1984, which is included in a taxpayer's federal taxable income solely as a result of an election made pursuant to the provisions of paragraph (8) of that section.

(2) Entire net income shall be determined without the exclusion, deduction or credit of:

(A) The amount of any specific exemption or credit allowed in any law of the United States imposing any tax on or measured by the income of corporations;

(B) Any part of any income from dividends or interest on any kind of stock, securities or indebtedness, except as provided in subsection (k)(1) of this section;

(C) Taxes paid or accrued to the United States on or measured by profits or income, or the tax imposed

by this act, or any tax paid or accrued with respect to subsidiary dividends excluded from entire net income as provided in subsection (k)(1) of this section;

(D) Net operating losses sustained during any year or period other than that covered by the report;

(E) 90% of interest on indebtedness owing directly or indirectly to holders of 10% or more of the aggregate outstanding shares of the taxpayer's capital stock of all classes; except that such interest may, in any event, be deducted

(i) Up to an amount not exceeding $1,000.00;

(ii) In full to the extent that it relates to bonds or other evidences of indebtedness, issued, with stock, pursuant to a bona fide plan of reorganization, to persons, who, prior to such reorganization, were bona fide creditors of the corporation or its predecessors, but were not stockholders or shareholders, thereof;

(iii) in full to the extent that it relates to debt of a financial business corporation owed to an affiliate corporation; provided that such interest rate does not exceed 2% over prime rate; the prime rate to be determined by the Commissioner of Banking;

(iv) In full to the extent that it relates to financing of motor vehicle inventory held for sale to customers providing said indebtedness is owned to a taxpayer customarily and routinely providing this type of financing;

(v) In full to the extent it relates to debt of a banking corporation to a bank holding company, of which the banking corporation is a subsidiary, or to a debt of a banking corporation to another banking corporation with respect to federal funds transactions governed by Section 23A of the Federal Reserve Act,

(12 U.S.C. § 371c.) when both banking corporations are subsidiaries of the same bank holding company, as defined in 12 U.S.C. § 1841.

(F)(i) The amount by which depreciation reported to the United States Treasury Department for property placed in service on and after January 1, 1981, for purposes of computing federal taxable income in accordance with section 168 of the Internal Revenue Code[4] in effect after December 31, 1980, exceeds the amount of depreciation determined in accordance with the Internal Revenue Code provisions in effect prior to January 1, 1981, but only with respect to a taxpayer's accounting period ending after December 31, 1981; provided, however, that where a taxpayer's accounting period begins in 1981 and 1982, no modification shall be required with respect to this paragraph (F) for the report filed for such period with respect to property placed in service during that part of the accounting period which occurs in 1981.

(ii) For the periods set forth in subparagraph (F)(i) of this subsection, any amount, except with respect to property described in section 168(f)(8)(D)(v) of the Internal Revenue Code as in effect immediately prior to January 1, 1984, which the taxpayer claimed as a deduction in computing federal income tax pursuant to a qualified lease agreement under paragraph (8) of that section.

The director shall promulgate rules and regulations necessary to carry out the provisions of this section, which rules shall provide, among others, the manner in which the remaining life of property shall be reported.

(3) The commissioner may, whenever necessary to properly reflect the entire net income of any taxpayer, determine the year or period in which any item of income or deduction shall be included, without being limited to the method of accounting employed by the taxpayer.

(4) There shall be allowed as a deduction from entire net income of a banking corporation, to the extent not deductible in determining federal taxable income, the eligible net income of an international banking facility determined as follows:

(A) The eligible net income of an international banking facility shall be the amount remaining after subtracting from the eligible gross income the applicable expenses;

(B) Eligible gross income shall be the gross income derived by an international banking facility, which shall include, but not be limited to, gross income derived from:

(i) Making, arranging for, placing or carrying loans to foreign persons, provided, however, that in the case of a foreign person which is an individual, or which is a foreign branch of a domestic corporation (other than a bank), or which is a foreign corporation or foreign partnership which is controlled, by one or more domestic corporations (other than banks), domestic partnerships or resident individuals, all the proceeds of the loan are for use outside of the United States;

(ii) Making or placing deposits with foreign persons which are banks or foreign branches of banks (including foreign subsidiaries) or foreign branches of the taxpayers or with other international banking facilities; or

(iii) Entering into foreign exchange trading or hedging transactions related to any of the transactions described in this paragraph;

(iv) Such other activities of an international banking facility may, from time to time, be authorized to engage in:

(C) Applicable expenses shall be any expense or other deductions attributable, directly or indirectly, to the eligible gross income described in paragraph (B) of this subsection.

N.J.S.A. 54:10A-5. Amount of franchise tax

The franchise tax to be annually assessed to and paid by each taxpayer shall be the sum of the amount computed under subsection (a) hereof, or in the alternative to the amount computed under subsection (a) hereof, the amount computed under subsection (f) hereof, and the amount computed under subsection (c) hereof:

(a) That portion of its entire net worth as may be allocable to this State as provided in section 6,[1] multiplied by the following rates: 2 mills per dollar on the first $100,000,000.00 of allocated net worth, 4/10 of a mill per dollar on the second $100,000,000.00, 3/10 of a mill per dollar on the third $100,000,000.00, and 2/10 of a mill per dollar on all amounts of allocated net worth in excess of $300,000,000.00; provided, however, that with respect to reports covering accounting or privilege periods set forth below, the rate shall be that percentage of the rate set forth in this subsection for the appropriate year:

Accounting or Privilege Periods Beginning on or After:	The Percentage of the Rate to be Imposed Shall Be:
April 1, 1983	75%
July 1, 1984	50%
July 1, 1985	25%
July 1, 1986	0

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[1]Section 54:10A-6.

(b) (Deleted by amendment, P.L.1968, c. 250, s. 2.)

(c) 3¼% of its entire net income or such portion thereof as may be allocable to this State as provided in section 6; provided, however, that with respect to reports covering accounting or privilege periods or parts thereof ending after December 31, 1967, the rate shall be 4¼%; and that with respect to reports covering accounting or privilege periods or parts thereof ending after December 31, 1971, the rate shall be 5½%; and that with respect to reports covering accounting of privilege periods or parts thereof ending after December 31, 1974, the rate shall be 7½%; and that with respect to reports covering accounting or privilege periods or parts thereof ending after December 31, 1979, the rate shall be 9%.

(d) Provided, however, that the franchise tax to be annually assessed to and paid by any investment company or real estate investment trust, which has elected to report as such and has filed its return in the form and within the time provided in this act and the rules and regulations promulgated in connection therewith, shall, in the case of an investment company, be measured by 25% of its entire net income and 25% of its entire net worth, and in the case of a real estate investment trust, by 4% of its entire net income and 15% of its entire net worth, at the rates hereinbefore set forth for the computation of tax on net income and net worth, respectively, but in no case less than $250.00, and further provided, however, that the franchise tax to be annually assessed to and paid by are regulated investment company which for a period covered by its report satisfies the requirements of Chapter 1, Subchapter M, Part I, Section 852(a) of the Federal Internal Revenue Code shall be $250.00.

(e) The tax assessed to any taxpayer pursuant to this section shall not be less than $25.00 in the case of a domestic corporation, $50.00 in the case of a foreign corporation, or $250.00 in the case of an investment company or regulated investment company.

(f) In lieu of the portion of the tax based on net worth and to be computed under subsection (a) of this section, any taxpayer, the value of whose total assets everywhere, less reasonable reserves for depreciation, as of the close of the period covered by its report, amounts to less than $150,000.00, may elect to pay the tax shown in a table which shall be promulgated by the director.

Amended by L.1966, c. 134, § 1, eff. June 17, 1966; L.1968, c. 112, § 1, eff. June 25, 1968; L.1968, c. 250, § 2, eff. Aug. 16, 1968; L.1970, c. 93, § 1; L.1972, c. 25, § 1, eff. May 17, 1972; L.1972, c. 89, § 2; L.1975, c. 162, § 1, eff. July 22, 1975; L.1979, c. 280, § 1, eff. Jan. 8, 1980; L.1982, c. 55, § 2; L.1983, c. 75, § 1, eff. Feb. 24, 1983

N.J.S.A. 54:10A-34. Banking corporations; annual franchise tax; deductions for international banking facilities

Every banking corporation shall pay an annual franchise tax in the year 1976 and each year thereafter, as provided in the Corporation Business Tax Act, P.L.1945, c. 162 (C. 54:10A-1 et seq.) for the privilege of having or exercising its corporate franchise in this State, or for the privilege of doing business, employing or owning capital or property, or maintaining an office in this State. For the purposes of this act, (1) the privilege period of each banking corporation shall be the calendar year, and the initial privilege period shall be the calendar year ending December 31, 1976; (2) January 1, 1976 and January 1, of each year thereafter shall be the assessment dates; (3) the tax on income shall be based upon the income of the calendar year preceding the assessment date; (4) net worth shall be determined as of the December 31 preceding the assessment date; and (5) income of a banking corporation in any privilege period shall include the income of any banking corporation merged into or consolidated with such banking

corporation in such privilege period. From and after January 1, 1976, no banking corporation shall be subject to the provisions of R.S. 54:9-1 through 54:9-18 and section 13 of P.L.1970, c. 8 (C. 54:9-19) but shall, to the extent and in the manner provided by this act, become and be subject to the provisions of the Corporation Business Tax Act and the Business Personal Property Tax Act, P.L.1966, c. 136 (C. 54:11A-1 et seq.). To effect the transition from taxation under R.S. 54:9-1 through 54:9-18 and section 13 of P.L.1970, c. 8, to taxation under the Corporation Business Tax Act, every banking corporation shall, within 90 days after the effective date of this act, but not later than December 1, 1975, pay to the State a sum equal to 60% of the amount of the tax that would have been due from such banking corporation had it been subject to taxation under the Corporation Business Tax Act during the calendar year ending December 31, 1974. Thereafter, as provided by the Corporation Business Tax Act, each banking corporation shall, on or before April 15 of each privilege period, commencing with the privilege period beginning January 1, 1976, file a tax return and pay the full amount of the tax determined to be due for the then current privilege period, and shall, in addition, pay a sum equal to 60% of the full amount of the tax due for such privilege period as an advance partial payment against the tax determined to be due for the next succeeding privilege period. Each such banking corporation shall, in the final calculation of the tax determined to be due from it for the 1976 privilege period, receive a credit for the 60% payment made by it on or before December 1, 1975 pursuant to this section, and thereafter, each banking corporation shall, in the final calculation of the tax determined to be due from

it for any subsequent privilege period, receive credit for the advance partial payment made by it in the next preceding privilege year. No banking corporation shall, in calculating its income for any of the purposes of taxation under the Corporation Business Tax Act deduct from its income the amount of any tax paid pursuant to R.S. 54:9-1 through 54:9-18 and section 13 of P.L.1970, c. 8 (C. 54:9-19). Any excess payment made in any privilege year shall be returned as provided in section 15 of the Corporation Business Tax Act (C. 54:10A-15). Notwithstanding anything contained in this act to the contrary during each of the privilege years 1976, 1977, 1978 and 1979, the amount to be paid by each banking corporation as taxes under this act shall be the greater of (1) the amount which such banking corporation paid in the calendar year 1975 as taxes pursuant to R.S. 54:9-1 through 54:9-18 and section 13 of P.L.1970, c. 8 or (2) a sum equal to the total of the taxes paid by such banking corporation pursuant to this section and section 5 of this act.[1] In any case where the corporate existence of a banking corporation transacting business on the effective date of this act terminates during a privilege period by voluntary or involuntary dissolution or by merger or consolidation, or otherwise, such banking corporation shall be liable for the payment of taxes under this section for the full privilege period in which such termination takes place.

The effect of the amendments to this act relating to international banking facilities shall be phased in over a 5 year-period. In order to implement the transition, each

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[1]Section 54:11A-21.

banking corporation which elects to utilize the deduction from entire net income for eligible net income from international banking facilities (provided in subsection (k)(4) of section 4 of P.L.1945, c. 162 (C. 54:10A-4) or the exclusion from net worth for international banking facilities (provided in subsection (d) of section 4 of P.L.1945, c. 162) shall, with its return for the first year in which it makes that election, file an information return for 1981 which shall report its income and net worth attributable to the activities referred to in subsection (k)(4) of section 4 of P.L.1945, c. 162 as if the taxpayer had an established international banking facility during the entire calender year 1981 and as if the amendments to this act relating to international banking facilities had been effective during that entire year. The difference between a taxpayer's corporate franchise tax liability for 1981 and the amount it would have been liable for if said amendments were in effect during 1981 shall be the taxpayer's base international banking facilities tax liability.

For each of the years 1982 through 1986 in which the taxpayer elects to utilize the deduction from entire net income for eligible net income from international banking facilities (provided in subsection (k)(4) of section 4 of P.L.1945, c. 162) or the exclusion from net worth for international banking facilities (provided in subsection (d) of section 4 of P.L.1945, c. 162), the taxpayer shall pay, in addition to the tax computed under section 5 of P.L.1945, c. 162 (C. 54:10-5) the following percentage of its base international banking facilities tax liability:

1982	100%
1983	80%
1984	60%
1985	40%
1986	20%

L.1975, c. 170, § 4, eff. Aug. 4, 1975. Amended by L.1978, c. 40 § 1, eff. June 19, 1978; L.1983, c. 422, § 3, eff. Jan. 5, 1984.

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(p. xxii) Replacement Tax

Business net income tax—applicable to corporations and unicorporated business—with present Corporation Franchise Tax as a deduction corporation pays greater of two taxes)	
Revised Franchise Tax with 3 per cent income alternative	$68 million
Present Franchise Tax	26 million
Increased corporation tax	$42 million
Unincorporated business tax (3 per cent)	9 million
Total additional tax	$51 million

State Revenues

Business income tax rates can be increased to provide additional State revenue—approximately $22 million for each 1 per cent of tax rate.

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(p. xxiii) Business Taxes

Alternative 1—would increase 1957 business taxes by $5.8 million—from $276.4 million to $282.2 million.

The net result of a $47.5 million reduction for business real estate and a $53.4 million increase for business personal property.

Alternative 2—would increase 1957 business taxes by $25.4 million—from $276.4 million to $301.8 million.

The net result of a $53.7 million reduction for business real estate, an increase of $28.1 for business personal property and a new $51 million business income tax.

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(p. 106) Alternative 2

The elements of an alternative plan complying with Section 2 of the Legislative Resolution (S. C. R. No. 28, Dec. 27, 1956) and which Commissioners Alexander and Dumont believe is the only alternative, may be summarized as follows:

Item	Tax in 1957
Exempt from Property Taxation	
Business inventories including farm crops and produce held for sale	$31.0 million
Household personal property	15.5 million
Total	$46.5 million
Other Property (real and personal)	
Uniform assessment at 40 per cent of full value—with provision that full value of business personalty may be presumed to be book value subject to review.	
Replacement Tax	
Business net income tax—applicable to corporations and unincorporated business —with present Corporation Franchise Tax as a deduction (corporation pays greater of two taxes).	
Revised Franchise Tax with 3 per cent income alternative	$68 million
Present Franchise Tax	$26 million
Increased corporation tax	$42 million
Unincorporated business tax (3 per cent)	9 million
Total additional tax	$51 million

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(p. 109) . . . to receive public acceptance, some alternative is required. The business net income tax, which is the heart of Alternative 2, would fulfill the conditions of a solution.

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(p. 115) Operation of the Business Income Tax

If a business income tax is to be adopted, the *Commission* contemplates that it would apply both to corporations and unincorporated business. In order to give equality to the tax base for these two different forms of business organizations, the legislation should provide for a deduction of reasonable compensation of partners or individual proprietors from the gross income of the enterprise in arriving at taxable net income. The *Commission's* recommendation for these and other details of the proposals are being incorporated in recommended legislative bills which will be separately submitted following the Report.

The effect of the recommendation that each taxpayer pay the greater of the net worth or the corporate income tax, in the case of corporate taxpayers, is shown in Table 5.5 for various industries.

Effects or Alternatives on Counties and Municipalities

The total effect of either Alternatives 1 or 2 from the viewpoint of municipal government should be considered as a composite result of the various elements, and not solely from the viewpoint of the 40 per cent ratio of assessed to true value on real estate.

In the tables that follow, the comparative effect of the present actual practice, 100 per cent assessments and the two alternatives, is illustrated for all the counties and the

principal municipalities with respect to the effect on the tax rate, the amount of taxes to be raised from each class of property, the relative effect on residences, business and farms, and their specific differences in relation to business total personal property and business inventories.

It is proposed that the yield of the new business income tax be divided as follows. An amount equal to the revenue from the net worth part of Corporation Franchise Tax be retained for State use. The balance of the yield of the franchise tax, including the 3 per cent net income alternative and the yield of the 3 per cent net income levy on unincorporated business shall be placed annually in a replacement fund. Each municipality's share of the replacement fund would be the equivalent of the proportion that its local property tax levy bears to the total of all local property tax levies throughout the State. Any yield of the business income tax from an increase of the rate above 3 per cent would be for State purposes.

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(p. 22) . . . Thus, any foreign corporation maintaining merely a sales office in New Jersey would presumably be taxable under a direct net income tax, whereas such a company would not ordinarily be taxable under a franchise-doing-business tax.[11] Within the interstate selling area, the recent *Clairol* case decided by the New Jersey court suggests that at least some State courts are giving P.L. 86-272 a rather narrow construction.[12] Moreover, the Federal statute does not restrict levies on transportation, banking, insurance, advertising, investment companies, securities brokerage, or any service industry, since it is confined solely to the selling of tangible personal property.

There have been persistent efforts in recent years to obtain the enactment of additional Federal legislation, which would both harmonize and further restrict State taxation of interstate business.[13] Thus far, these legislative efforts have been unsuccessful, doubtless to a considerable extent because a good many States have joined

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[11]In Roadway Express, Inc. v. Director, Division of Taxation, 50 N.J. 471, 236 A. 2d 577, appeal dismissed, 390 U.S. 745 (1968), the New Jersey Supreme Court indicated it [sic] dissatisfaction with the holding of the Supreme Court of the United States that a franchise tax may not be imposed on a foreign corporation doing an extensive business in the State, albeit exclusively interstate. Nevertheless, the New Jersey Court found other grounds for distinguishing the cases applying that doctrine. Hence, the U.S. Supreme Court's dismissal of the taxpayer's appeal cannot be read as overruling the prohibition of franchise taxes on interstate business.

[12]See Note 10, supra.

[13]The Willis Subcommittee of the House Judiciary Committee, after an extensive five-year study, recommended that Congress curtail the powers of the States to tax interstate businesses beyond the restrictions imposed by P.L. 86-272. See "State Taxation of Interstate Commerce", H.R. Rep. No. 1480

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in the Multistate Tax Compact.[14] The Compact is designed in part to solve by voluntary, cooperative State action some of the more frequently voiced complaints against the lack of uniformity in the apportionment and allocation of the income of interstate business, but it does not generally restrict the taxing jurisdiction of the States.

We conclude that under the applicable constitutional provisions and existing Congressional restrictions on the taxing powers of the States, there is a good deal of room for broadening the scope of the Corporation Business Tax by enacting a second-tier net income tax.

The Committee Recommends:

Because we believe equity demands business carrying on activities in the State and exploiting the New Jersey market make some contribution to the costs of maintining governmental operations and the services provided by the State, we recommend the adoption of a second-tier net income tax, as part of the Corporation Business Tax, to be applied to corpo-

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(88th Cong., 2d Sess., 1964). Bills to achieve that end have been before Congress since 1965; one bill passed the House at an earlier session but not the Senate (H.R. 11798, 89th Cong.) 1st Sess.), and several bills are now pending in the Congress (see the Rodino Bill, H.R. 1538, Int. Jan. 22, 1971, P-H State and Local Tax Serv., All States Unit, Par. 6401, and the Ribicoff Bill, S. 317, id. Par. 6541, Int. Jan. 27, 1971).

[14]There are now 21 States which have become parties to the Compact, and 15 States, including New Jersey, which are not parties to the Compact, but are non-voting Associate Members of the Multistate Tax Commission, which administers the Compact. See P-H State and Local Tax Serv., All States Unit, Pars. 5150-5151, for a listing of the parties to the Compact and the Associate Members, and Par. 6301 for the provisions of the Compact. On March 9, 1971, the State of New York withdrew as an Associate Member. The Magnuson Bill (S. 1883, Int. May 17, 1971), now pending in Congress, provides the Congressional consent to the Compact. Idem, Par. 6371.

rations deriving income from the State. which are not subject to the present franchise tax or income tax. Because of the lack of useful data, the committee does does not recommend a specific revenue anticipation from this correction of inequity, but experience in other states suggests, possible revenue of $2 to $4 millions.

Net Worth Tax as a Minimum Alternative

The evolution of the present Corporation Business Tax was summarized in the *12th Report* of the Commission on State Tax Policy (pp. 34-35) and need not be retraced here. The current net worth tax as developed as a replacement for both the 1885 capital stock tax and the intangible property tax on corporations; the net income tax is a comparative newcomer in New Jersey corporate taxation, having been added to the Corporate Business Tax in 1958.

Over the decades, the tendency in State taxation has been to substitute the corporate net income tax for the traditional capital stock and net worth taxes, and in some States to retain the latter type of tax only as a minimum alternative levy to the net income tax. Nevertheless, there are a number of States that follow the New Jersey practice of imposing a two-pronged corporate net worth and income tax.[15]

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[15]The existing capital stock taxes are enumerated in P-H State and Local Tax Service, Par. 1050, All States Unit. Some States have reduced the importance of the capital stock tax by adopting a comparatively low maximum levy, particularly where it is a tax on the number of shares of stock authorized or outstanding; such levies are not comparable to New Jersey's tax on the value of the corporation's capital stock, i.e., its net worth. Pennsylvania is one of the States which has a two-pronged net income and capital stock tax.